



## 10 Reasons Why Public Policies Rescued the U.S. Economy

Christian E. Weller | May 29, 2012

Many conservatives argue that our economy can flourish only when the federal government gets out of the private sector's way. Many progressives counter that in our free market system, there are times when the government needs to step in to protect the common good and ensure there is broad-based economic growth. This debate defines our politics today.

Americans of all political persuasions, however, should agree that quick and decisive government action was necessary between 2008 and 2010 to avoid a second Great Depression and to help our economy recover from the deepest recession since the 1930s. After all, the evidence is clear that three acts of Congress signed by two successive presidents between 2008 and 2010 led to the end of the Great Recession of 2007–2009 and the subsequent economic recovery. Specifically:

- The Troubled Asset Relief Program of 2008 rescued our financial system from almost certain meltdown, saving the U.S. financial system at the brink of disaster
- The American Recovery and Reinvestment Act of 2009 helped us avoid the feared second Great Depression and kickstarted renewed economic growth
- The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 strengthened the fledgling economic recovery by cutting the payroll tax and continuing extended unemployment insurance benefits

This column will detail the top 10 reasons why these three key government interventions in the economy were successful. But first, let's briefly recount the reasons why such government action was necessary in the first place.

Remember the situation in 2008? Our economy, employment, and Wall Street were all about to go off the cliff. The time between then and now was marked by a sharp economic contraction alongside massive job losses and steep stock market losses—followed by slow, at times uneven, but still steady recoveries in economic growth and the labor and financial markets. Federal government policies had a lot to do with making sure that the deep dive was not lengthier, and that the recovery happened sooner than it otherwise would have. The labor market, the economy, and financial markets are clearly on the mend. This is a far cry from the situation in 2008.

The Troubled Asset Relief Program in 2008, the American Recovery and Reinvestment Act of 2009, and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 successively helped the U.S. economy turn itself around. These three measures came at crucial times when the economy was facing the prospect of experiencing serious damage unless policymakers took decisive, targeted, and quick actions.

The Troubled Asset Relief Program was enacted in October 2008 so that the federal government could use \$700 billion to stabilize the struggling financial system. Much of the first half of that money was spent injecting cash into troubled banks during the final months of 2008, ensuring that our financial system did not collapse. The American Recovery and Reinvestment Act was enacted in February 2009, implementing a series of tax cuts and spending measures that totaled \$787 billion for almost two years through the end of 2010. Additional unemployment insurance and Social Security benefits started to flow almost immediately due to the Recovery Act, while it took until the summer of 2009 for infrastructure spending to start. Congress then enacted new payroll tax cuts and continued extended unemployment insurance benefits in December 2010 as the Recovery Act's benefits ran out.

The result: Financial markets, the economy, and the labor market started to improve quickly after each measure had been passed and money started coming to key struggling markets. These three policy measures did exactly what they were meant to do—policymakers acted to avoid worsening economic conditions.

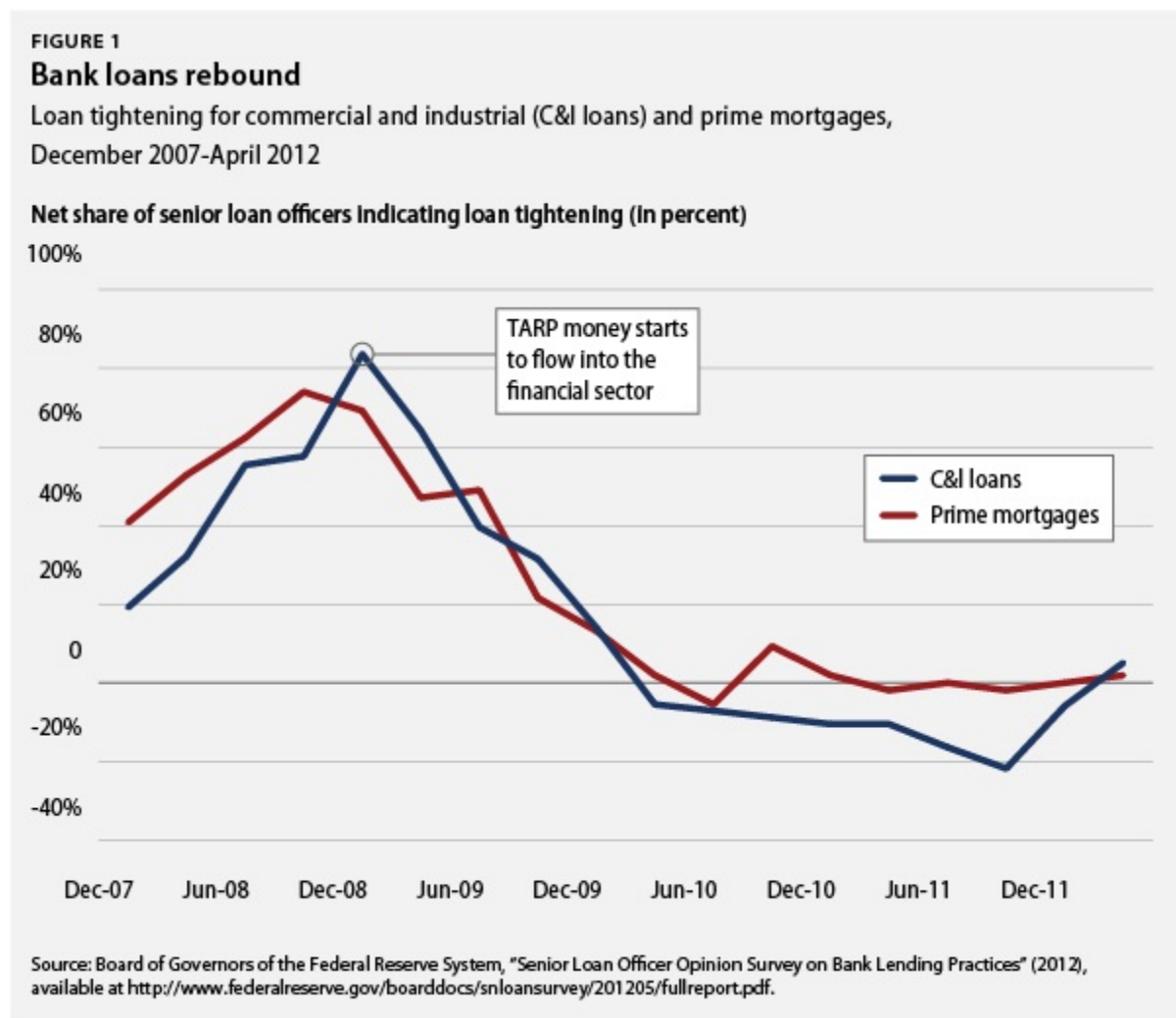
To be sure, these policy interventions could have been more effective and efficient if they had delivered a stronger bang for their buck. The Troubled Asset Relief Program could have included more help for struggling homeowners. The Recovery Act could have included more infrastructure spending, and the payroll tax cuts and extended unemployment insurance benefits could have been decoupled from wasteful tax cuts for the rich. None of this extra help for our economy and workers was possible, though, because of conservative opposition to more effective and efficient policy interventions.

Still, the Troubled Asset Relief Program saved the financial system from implosion. While one can legitimately question the design of the program, whether the benefits from it were fairly shared, and whether the funds were used as efficiently as possible for the long run, there's little question

that it did benefit the economy. The Recovery Act certainly prevented another Great Depression. And the payroll tax cuts and extended unemployment insurance benefits continue to strengthen the economic recovery today.

Here's a rundown of the 10 ways recent economic and financial data show that each of these three policy measures worked as intended, beginning with the Troubled Asset Relief Program, then the Recovery Act, then the most recent payroll tax cuts and extended unemployment insurance benefits.

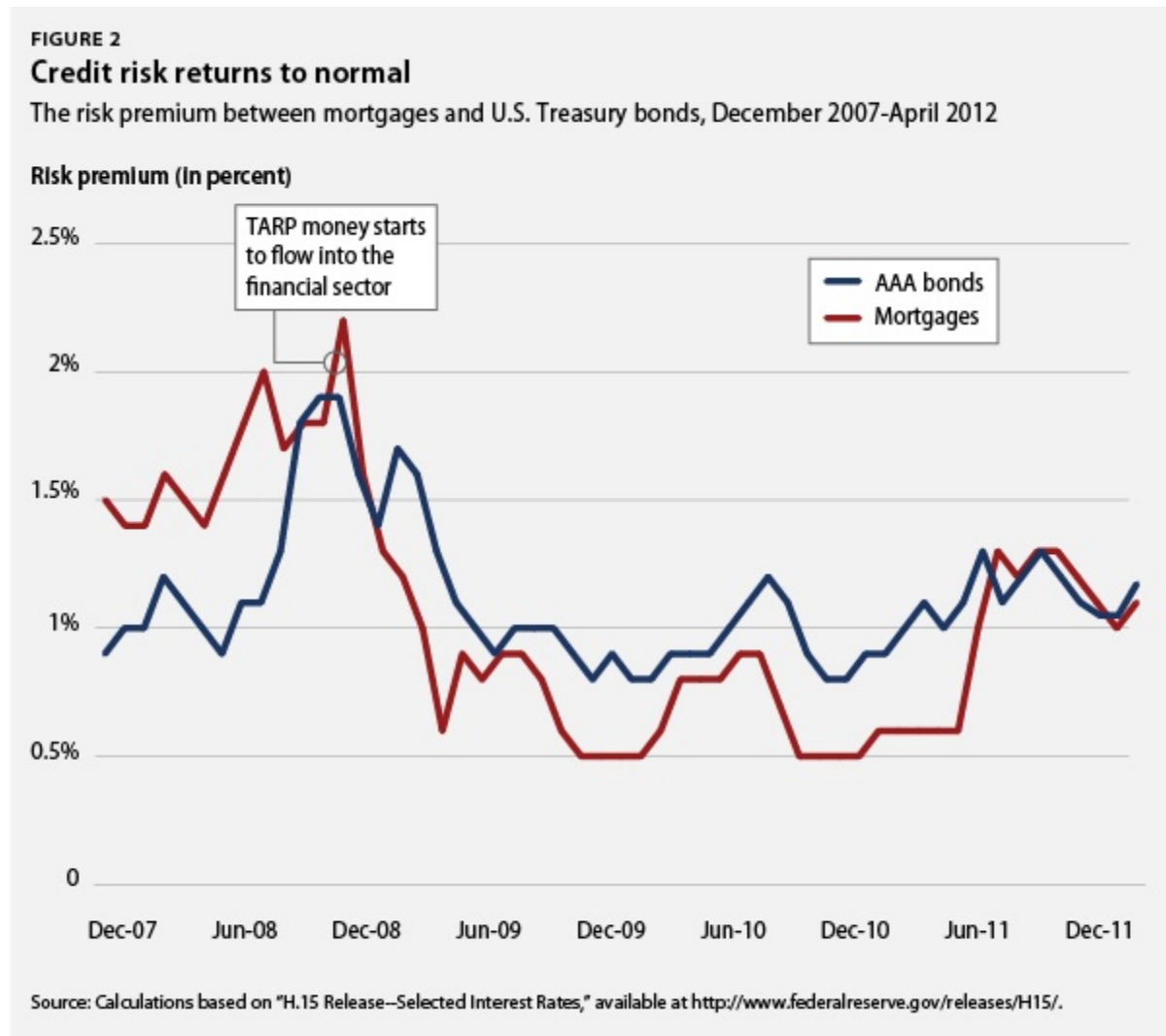
### ***Loan tightening eased with the introduction of the Troubled Asset Relief Program***



A peak net high of 83.6 percent of senior loan officers indicated that they were tightening lending standards for commercial and industrial loans in the fourth quarter of 2008, up from 19.2 percent in the fourth quarter in 2007. This ratio fell continuously throughout 2009. The senior loan officer ratio is an indirect but telling measure of how easy or hard it is for businesses and households to get a loan from a bank.

Similarly, a net 69.2 percent of senior loan officers indicated tightening prime mortgage standards in the fourth quarter of 2008, up from 40.8 percent in December 2007, before falling to 24.1 percent in the fourth quarter of 2009. Banks first tightened lending standards in the face of the worst financial crisis since the Great Depression and started to ease lending standards after the Troubled Asset Relief Program stabilized the U.S. financial sector.[1] Business and mortgage credit markets became less tight immediately following TARP.

***Interest rates ease shortly after the Troubled Asset Relief Program is enacted***



The additional interest rate—the so-called risk premium—charged on mortgages above the interest rate on risk-free U.S. Treasury bonds rose to a peak of 2.2 percent in December 2008, up from 1.5 percent in December 2007, when the Great Recession started. The difference fell back to 1.6 percent by January 2009 after Troubled Asset Relief Program money flowed into credit markets. This risk premium hovers typically around 1 percent during normal economic times.

The risk premium on corporate bonds went from 0.9 percent in December 2007 to a peak of 1.9 percent in December 2008, before falling to 1.6 percent in January 2009. The risk premium first went up as lenders became worried about the state of other banks, and it fell back down as the

Troubled Asset Relief Program provided much-needed backing to struggling banks.[2] Homeowners and businesses had to pay less for their loans as financial market risk declined due to the success of the program.

***The specter for deflation disappeared after the passage of the Troubled Asset Relief Program and the Recovery Act***

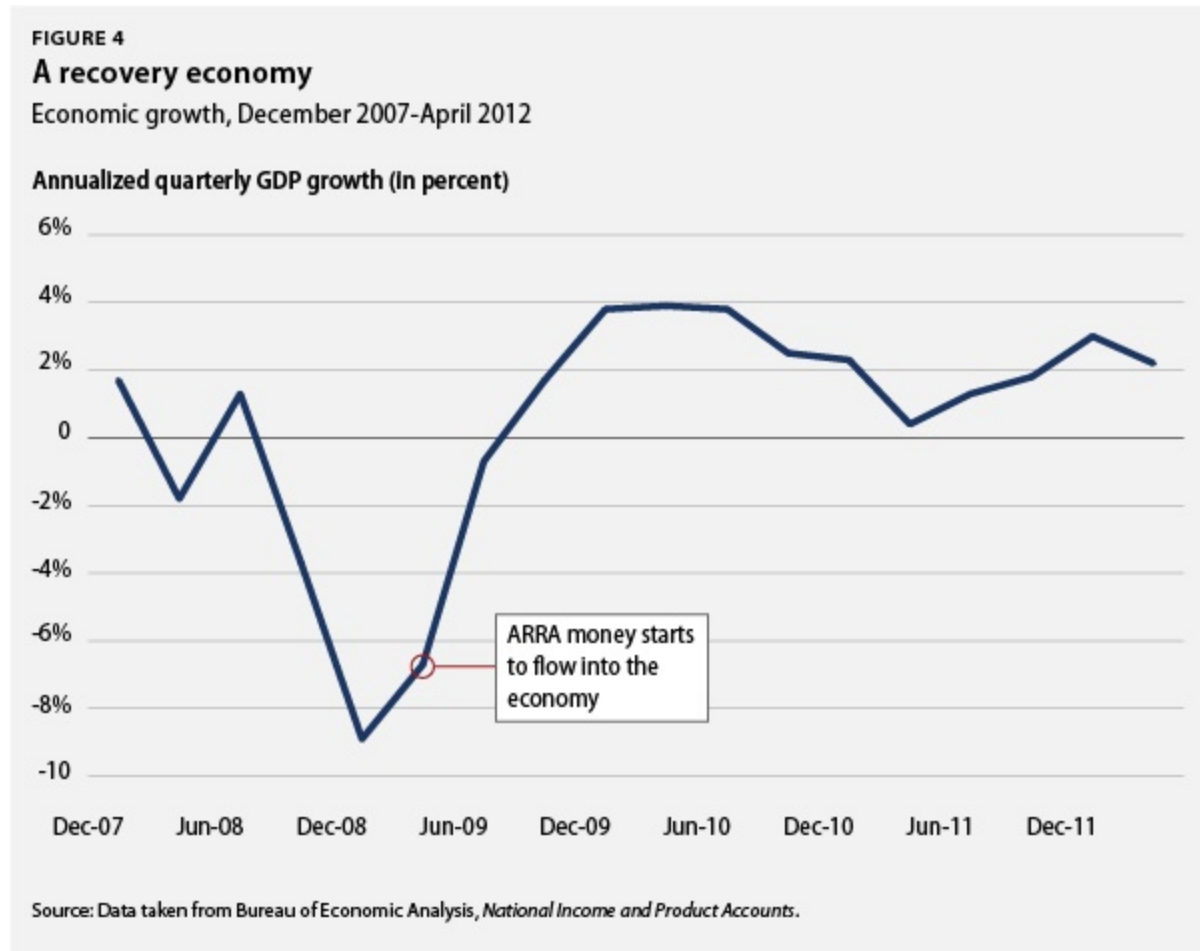


Falling inflationary expectations hold the danger that they can lead to deflation—an economy in which prices fall. Deflation makes a recession much worse because businesses and consumers hold back on major purchases as they expect prices to fall. The U.S. economy had to contend with the specter of deflation in the fall of 2008 and winter of 2009; then the passage of the Troubled Asset Relief Program and the Recovery Act put people’s mind a little at ease.

In December 2008 the expected inflation rate for the coming five years stood at -0.24 percent, based on the difference between inflation-protected U.S. Treasury bonds and noninflation-protected Treasury bonds, down from 2.2 percent in December 2007—indicating that deflation was a real fear among investors. The difference between so-called Treasury Inflation Protected Securities and Treasury bonds of the same maturity is what gauges the expected inflation rate for the specific maturity—in this case five years. Inflationary expectations exceeded 1 percent again by May 2009 and reached 1.9 percent by December 2009.[3] Modest expected price increases—

around 2 percent—will lead businesses to invest more and consumers to spend more than they otherwise would have, while lower price increases will give them pause on their spending.

### ***Economic growth prospects brightened with the passage of the Recovery Act***



Expectations about future economic growth matter for actual growth—businesses will invest more, banks will lend more, and consumers will spend more than they otherwise would have if they think the economy will improve faster. The nonpartisan Congressional Budget Office increased its growth projections for 2010—the first full year after enactment of the Recovery Act—from 1.5 percent in January 2009 to 2.9 percent in March 2009.[4] And sure enough, economic activity picked up quickly.

The economy had declined in three out of the four quarters of 2008, and annual inflation-adjusted economic growth in the first quarter of 2009 was -6.7 percent. But with the enactment of the Recovery Act in the second quarter of 2009, our economy fell by only 0.7 percent in that quarter as government spending began. Then, in the third and fourth quarters of 2009, the economy grew by 1.7 percent and 3.8 percent, respectively, in large measure because the tax cuts and spending measures enacted under the Recovery Act started to flow into people's and businesses' pockets.[5]

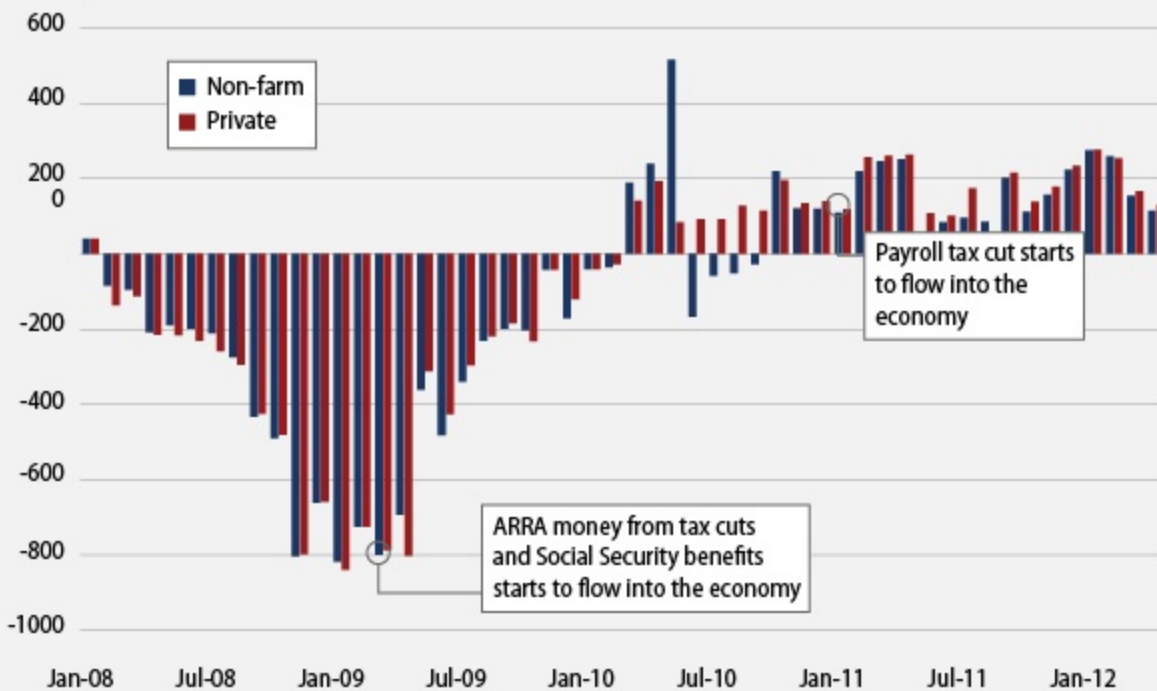
## Job losses quickly abated due to Recovery Act spending

FIGURE 5

### Boosting jobs growth

Annualized quarterly change in the jobs lost and gained, January 2008-April 2012

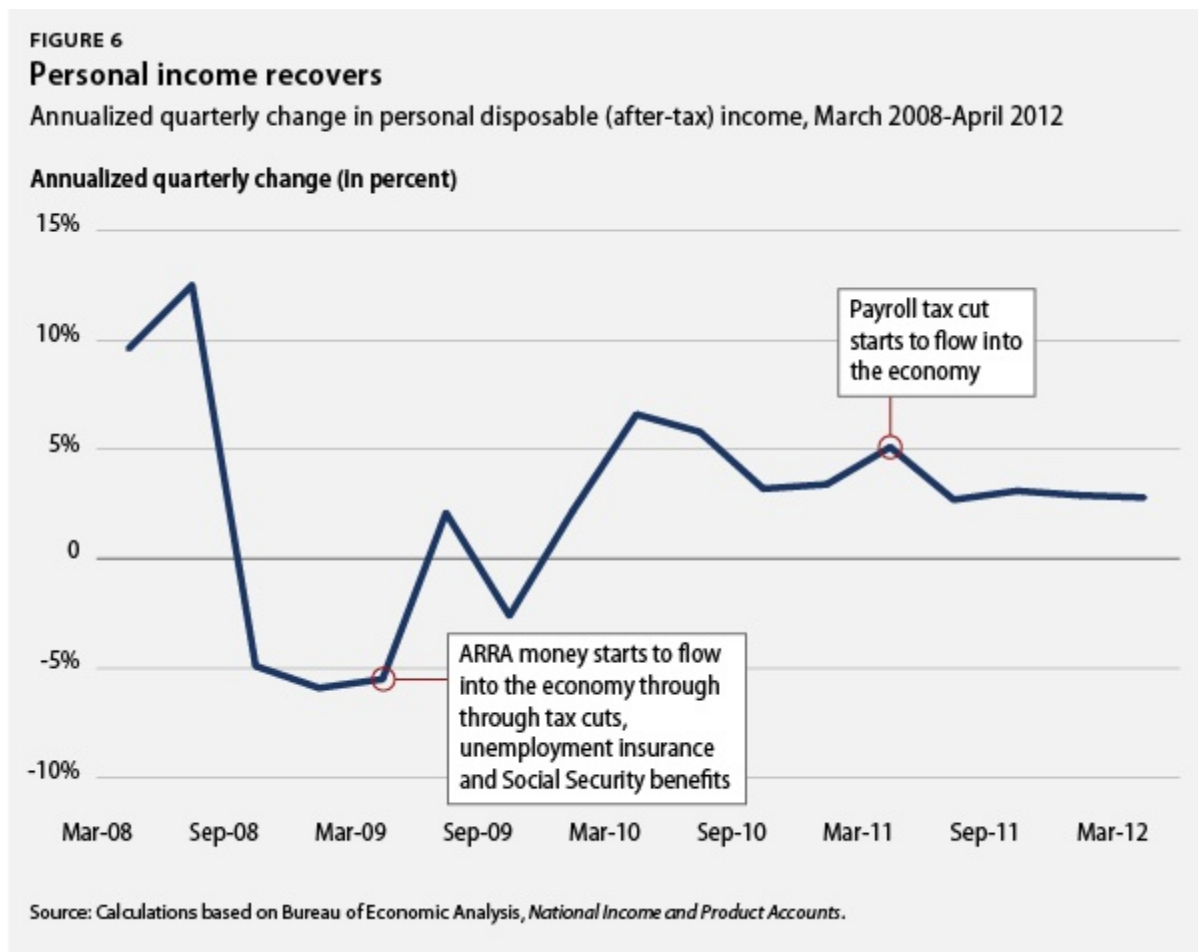
Monthly job changes (In thousands)



Source: Calculations based on Bureau of Labor Statistics, *Current Employment Statistics*.

Job losses dropped by 82.3 percent, from an average of 780,000 jobs lost in the first three months of 2009 when the law was passed to 138,000 per month in the final three months of 2009.[6] Private-sector job losses decreased by 83.2 percent—from 784,000 on average to 131,000—during the same period. The first quarter of 2009 marked the period of the steepest job losses of the Great Recession and a clear turning point in the labor market.[7]

## ***Personal disposable incomes started to rise again with help from the Recovery Act***



Personal disposable after-tax income fell from the middle of 2008 to the first quarter of 2009, as people lost their jobs in droves. Personal disposable incomes rose again in the second quarter of 2009 due to higher unemployment insurance benefits, larger Social Security payments, and lower personal taxes, all of which were part of the Recovery Act. This quickly helped struggling families.[8]

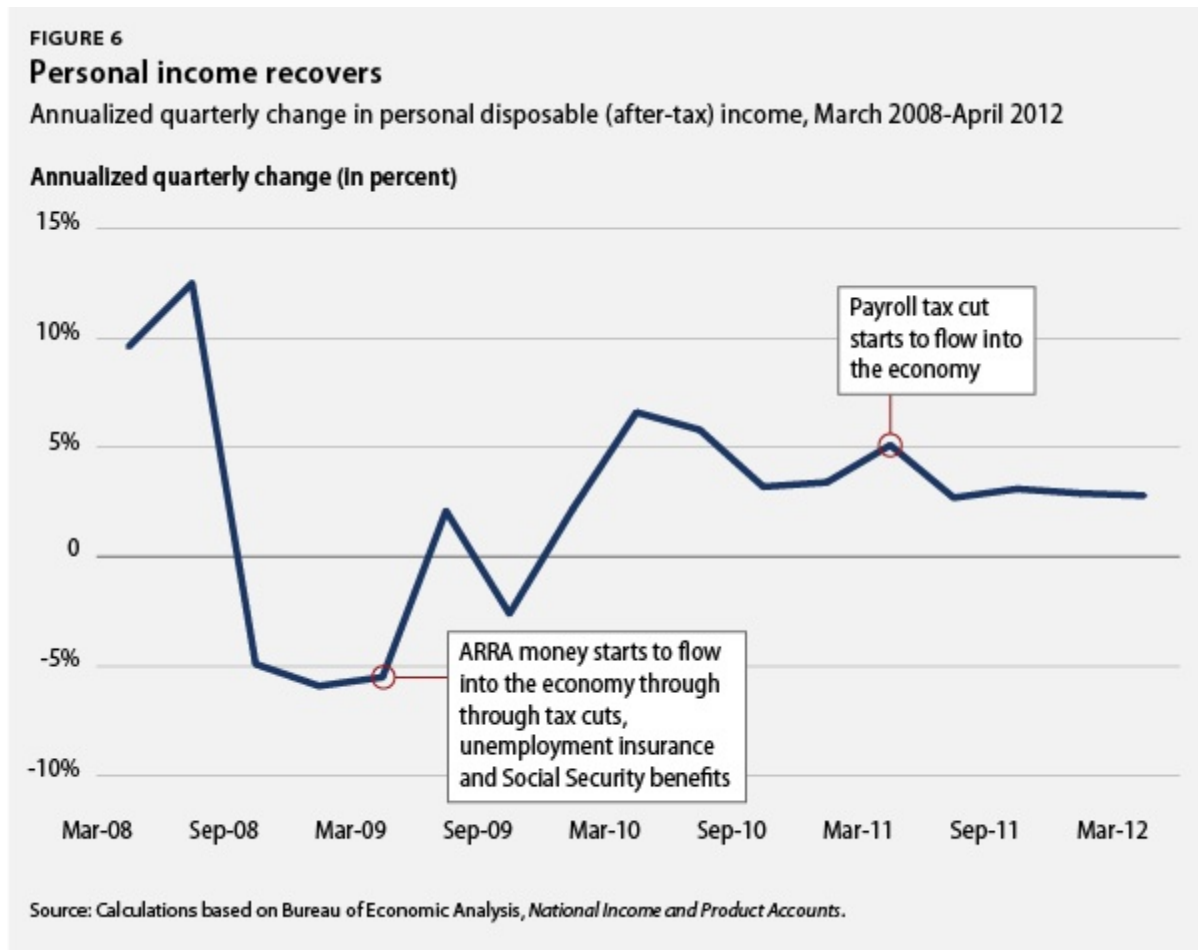
Families ended up with more money in their pockets, thanks to immediate spending under the new law, even though job losses continued at the same time. But other measures in the Recovery Act that took a little more time to boost consumer spending consequently helped improve employment prospects by putting more money into people's pockets.

***Industrial production turned around with infrastructure spending spurred by the Recovery Act***



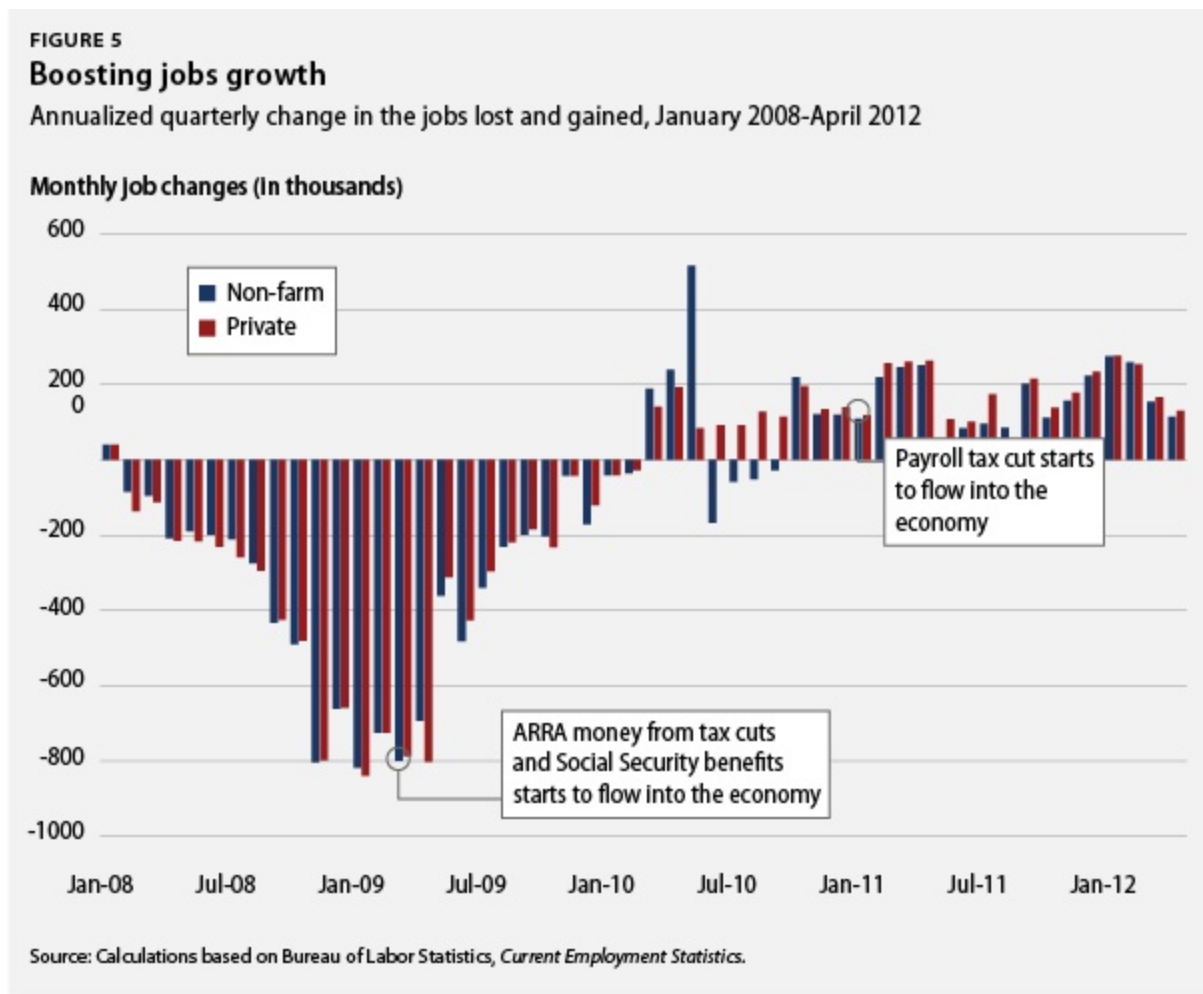
Industrial production—the output of manufacturing and utilities—declined consistently from December 2007 to June 2009. Industrial production started growing again in July 2009, when infrastructure spending from the Recovery Act started to flow into the economy. Industrial production was 3.7 percent larger in December 2009 than in June 2009, after having grown consistently for six months.[9]

**After-tax income grew more quickly following the payroll tax cut**



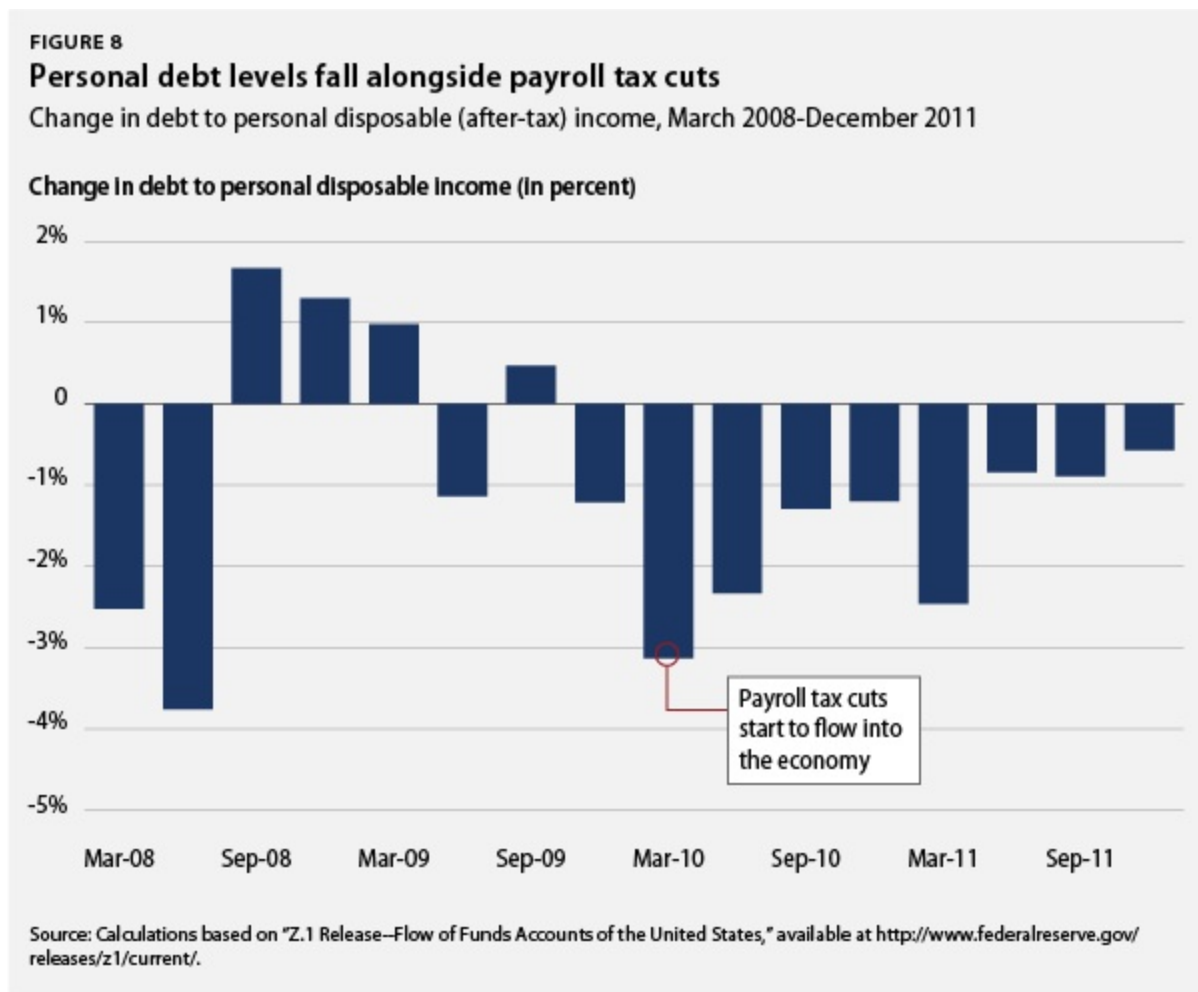
After-tax income expanded by 1.3 percent in the first quarter of 2011, immediately after the payroll tax cut in addition to an extension of extended unemployment insurance benefits was passed—the fastest growth rate since the second quarter of 2010.[10] The payroll tax cut put more money in people’s pockets, as the labor market continued to add new jobs at a slow pace. The additional money thus quickly strengthened an economic recovery that was trying to find its footing, helping to further boost jobs growth.

## Job growth accelerated with the payroll tax cut



Indeed, the labor market added an average of 192,000 jobs each month during the first three months of 2011, up from 154,000 jobs in the preceding three months. The payroll tax cut injected some additional momentum into a weak labor market.[11]

## ***Household debt burdens fell more quickly with the payroll tax cut***



Households had more money in their pockets and used some of the additional money to reduce their crushing debt burdens. The ratio of total household debt to after-tax income fell by 2.5 percentage points in the first quarter of 2011, more than twice as fast as in the fourth quarter of 2010 and faster than in any quarter of 2010.[12]

These 10 reasons why quick and decisive action on the part of the federal government turned an anticipated second Great Depression into the tough but steady economic recovery we are experiencing today are grounded in solid economic data. There is plenty of room for debate about the extent to which the government should be involved in the everyday workings of the economy, but there is absolutely no reason to second guess why our economy is not mired in a prolonged, 1930s-like depression. In this case, thoughtful government policies did the trick, just as they were supposed to.

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## Endnotes

[1] The net percentage is the difference between the share of loan officers indicating tightening standards minus the share of loan officers indicating easing lending standards. A positive number shows that more loan officers tightened loan standards than eased them, while a negative number shows that more loan officers eased loan standards than tightened them. See: Board of Governors of the Federal Reserve System, “Senior Loan Officer Opinion Survey on Bank Lending Practices” (2012), available at <http://www.federalreserve.gov/boarddocs/snloansurvey/201205/fullreport.pdf>.

[2] Calculations based on: “H.15 Release--Selected Interest Rates,” available at <http://www.federalreserve.gov/releases/H15/>. Mortgage interest rates are for conventional mortgages. Bond rates are for AAA-rated corporate bonds.

[3] Inflation expectations are the interest rate difference between nominal five-year U.S. Treasury bonds and inflation-indexed five-year Treasury bonds. Comparisons of Treasury bonds with other maturities show similar trends. Calculations based on: “H.15 Release--Selected Interest Rates.”

[4] The Congressional Budget Office incorporated new growth data for 2008 and 2009, which showed that the recession was worse than initially thought. See: Congressional Budget Office, “Budget and Economic Outlook” (2009); Congressional Budget Office, “A Preliminary Analysis of the President’s Budget and an Update on CBO’s Budget and Economic Outlook” (2009). The actual inflation-adjusted economic growth rate for 2010 was 3 percent. See: Bureau of Economic Analysis, *National Income and Product Accounts* (Department of Commerce, 2012). The improved outlook for 2010 also compensated for a worse-than-previously projected recession. CBO reduced the growth rate for all 2009 from -2.2 percent in January 2009 to -3 percent in March 2009. But CBO projected a growth rate of -1.5 percent from December 2008 to December 2009 both in January 2009 and in March 2009. The changes from December to December can stay the same, even if the total year growth rates fall if the economy is forecast to go into a deeper recession and then recover more quickly in 2009. That is, CBO projected that the Recovery Act would quickly contribute to growth in the second half of 2009, thus overcoming the sharper expected decline in the first half of the year. Quarterly growth projections, though, are not available.

[5] Data taken from: Bureau of Economic Analysis, *National Income and Product Accounts*.

[6] Calculations based on: Bureau of Labor Statistics, *Current Employment Statistics* (Department of Labor, 2011). The bullet point reports three-month averages since monthly job changes tend to be fairly volatile. Monthly job changes, though, show the same trend as quarterly averages.

[7] Calculations based on Bureau of Labor Statistics, *Current Employment Statistics*.

[8] The effect of lower taxes and other social spending on raising personal disposable incomes are more noticeable in the second quarter of 2009 than afterward. Taxes didn’t

fall further and other social spending did not increase more in the subsequent quarters. Instead taxes stayed low and social spending, other than Social Security, health care, and unemployment insurance, stayed high. Social Security and unemployment insurance payments increased as more people retire and collected unemployment insurance benefits throughout the rest of 2009. Calculations based on: Bureau of Economic Analysis, *National Income and Product Accounts*.

[9] Calculations based on: “Industrial Production and Capacity Utilization – G-17,” available at <http://www.federalreserve.gov/releases/g17/default.htm>.

[10] Calculations based on: Bureau of Economic Analysis, *National Income and Product Accounts*.

[11] The labor market weakened again in the subsequent three months due to the economic uncertainty associated with the negotiations over the federal debt ceiling—the maximum amount the federal government can borrow without congressional approval. See, for instance: Scott Lilly, “Creating Unemployment: How Congressional Budget Decisions are Putting Americans out of Work and Increasing the Risk of a Second Recession” (Washington: Center for American Progress, 2011), available at [http://www.americanprogress.org/issues/2011/10/creating\\_unemployment.html](http://www.americanprogress.org/issues/2011/10/creating_unemployment.html);

Michael Ettlinger and Michael Linden, “Default Dangers amid Slowing Economy: Latest Economic Growth Figures Highlight Cost of Debt Limit Standoff,” Center for American Progress, July 29, 2011, available at [http://www.americanprogress.org/issues/2011/07/default\\_dangers.html](http://www.americanprogress.org/issues/2011/07/default_dangers.html).

[12] Calculations based on: “Z.1 Release--Flow of Funds Accounts of the United States,” available at <http://www.federalreserve.gov/releases/z1/current/>. For more details on the links between after-tax income, deleveraging, and economic growth, see: Christian E. Weller, “Lending a Hand to the Maxed-Out Consumer: Congress Should Extend the Payroll Tax Holiday,” Center for American Progress, December 13, 2011, available at [http://www.americanprogress.org/issues/2011/12/payroll\\_tax.html](http://www.americanprogress.org/issues/2011/12/payroll_tax.html); Christian E. Weller, “Unburdening America’s Middle Class: Shrinking Families’ Debt Burden Faster is Imperative for Strong, Sustained Economic Growth” (Washington: Center for American Progress, 2011).