Slow Recovery Without Continued Policy Interventions

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Introduction

The U.S. economy is on the mend. Economic growth returned in the middle of 2009, reversing course after the worst recession since the Great Depression.

The economic recovery that has since ensued has been remarkably weak. Economic growth has not been strong enough nationally to propel job growth to the levels necessary to reduce the unemployment rate.

A number of factors hold back growth. Chief among these factors is slow consumption growth. Consumers do not have sufficient resources to spend more money since they are rebuilding their lost wealth and are focusing on reducing their debt burden. Household deleveraging will likely continue into the second half of this decade, slowing consumption and economic growth. State and local government budget deficits and large trade deficits also contribute to the current slow growth pattern.

The Massachusetts economy performs comparatively better than the rest of the country. Its unemployment rate has stayed below the national average and has fallen faster than has been the case elsewhere. Still, with more than 8 percent of the population out of work, the unemployment rate won't fall substantially without a stronger recovery in other parts of the country.

A stronger recovery in the near term, though, will depend in large measure on the success of public policy interventions, considering the formidable obstacles to a strong, self-sustaining recovery. The federal government's initial economic stabilization measures, the American Recovery and Reinvestment Act of 2009 (ARRA) is slowly winding down. It will in all likelihood be replaced by a series of tax and spending measures targeted at boosting personal incomes and consumption under the Middle Class Tax Relief Act of 2010.

The economy is expected to see most of the gains from this new stimulus effort in 2011. Economic forecasters put the additional growth from the combination of new spending and tax cut measures generally at about one percentage point for 2011. The additional growth effect in 2012 will likely be substantially smaller than that since the measures most likely to generate growth are limited to 2011.

Massachusetts will likely gain an equal or smaller amount in economic growth from the new stimulus. Massachusetts has fewer unemployed workers than the rest of the country and thus will not be able to take as much advantage of the new spending dedicated to extended unemployment insurance benefits. Moreover, public-sector employees in Massachusetts contribute to state and local government retirement systems instead of Social Security. The payroll tax holiday—a cut of the Social Security payroll tax for one year—that is part of the new policy measure will thus have a smaller effect in Massachusetts than in most other states. Massachusetts may lose more than $300 million in potential economic stimulus because this provision excludes public-sector workers here. The contribution to economic growth from the new spending and tax measures will consequently be equal or less in Massachusetts than in the rest of the country.

The recovery struggles to gain momentum

The U.S. economy officially emerged from the worst recession since the Great Depression in June 2009.[1] Positive economic growth has characterized the economy since then. The economy has expanded by a total of $467.4 billion (in 2005 dollars) between June 2009 and September 2010—the equivalent of an average annualized growth rate of 2.9 percent for these fifteen months.[2]

This is a sharp improvement from the preceding 18 months, when economic activity shrunk quickly. The U.S. economy contracted for five out of six quarters between December 2007 and June 2009 at an average annualized rate of -2.8 percent.[3]

The speed of the recovery, though, has not been fast enough to make a dent in the labor market. The national unemployment rate stood at 9.8 percent in November 2010, slightly above the level of 9.5 percent in June 2009.[4] The unemployment rate budged little in 2010, even though the labor market added 951,000 jobs in the first eleven months of 2010.[5] Job growth essentially has fallen behind population growth in 2010. Economic growth is not yet fast enough to generate a strong, self-sustaining recovery that will substantially reduce the unemployment rate in the near future.

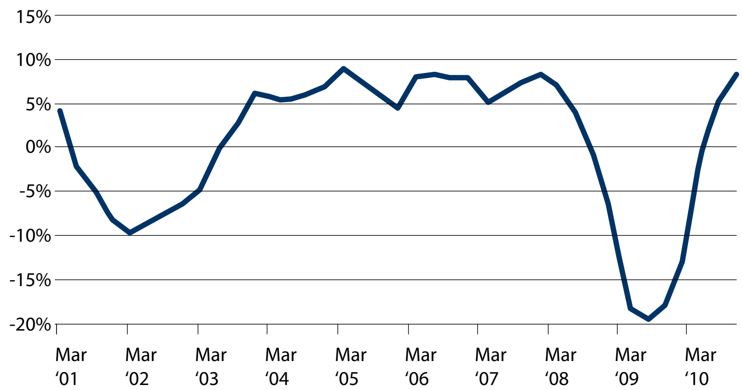
What is holding back economic growth? A recovery typically relies on a surge in private business investment to generate enough momentum to boost consumption and job growth. The current recovery has indeed seen a surge in business investment growth. The year-over-year increase in business investment soared to 8.3 percent by September 2010 (see Figure 1). This was the highest year-over-year investment increase since the one-year period that ended in March 2005.[6]

The resurgence in business investment, although very welcome, was not enough to drive economic growth to high enough levels necessary to reduce the national unemployment rate. Strong business investment is important, but economic growth is slowed by the other parts of the economy: consumer spending, government spending, and trade deficits.

FIGURE 1

Investment growth, year-over-year

2001–2010, percent growth



Notes: Bureau of Economic Analysis, "National Income and Product Accounts" (2010).

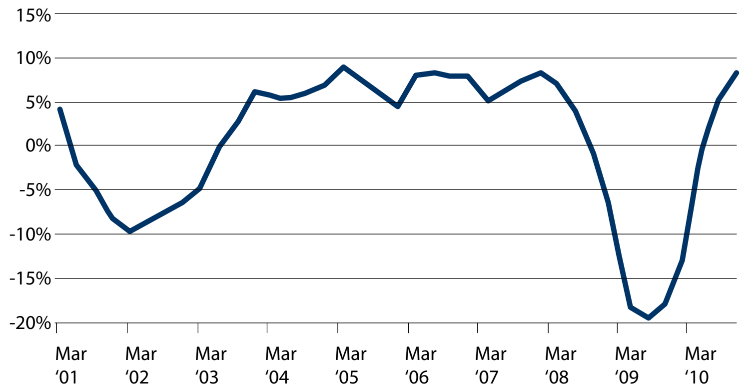
Maxed out consumers focus on rebuilding their nest eggs and reducing their debt burden

Consumption is the single largest component of the economy. Consumer spending, outside of spending on owner-occupied housing, makes up about 70 percent of the entire economy.[7] Consumption, though, has grown by only 1.9 percent in real terms from June 2009 to September 2010. In comparison, consumption grew on average by 3.5 percent during the 1990s and still by 2.4 percent during the relatively slow growth era of the 2000s—from March 2001 to December 2007.[8] Consumer spending in this recovery has undoubtedly been subpar.

Two factors explain the reluctant consumer. First, consumers are scared of the economic environment and have subsequently increased their savings. The personal saving rate has gone from about two percent of after-tax income in 2007—the last year before the recession—to about six percent in 2010.[9] Households desperately need the additional savings. Total household wealth was still $11.9 trillion (in 2010) lower in September 2010 than it was at the start of the recession in December 2007. Second, consumers have switched from profligate borrowers to debt consolidators since the recession started. Total consumer debt was $922 billion lower in September 2010 than in December 2007, at the start of the recession. Consumer debt actually declined for seven quarters in a row, from December 2008 to September 2009, the longest such period of household deleveraging – decreasing debt burdens—since the Federal Reserve collected the data in 1952. Households, though, still struggled from a comparatively high debt burden in late 2010, despite this historically unprecedented deleveraging (see Figure 2). Household debt to after-tax income amounted to 118 percent in September 2010. This was a far cry from the record high of 130 percent in June 2007, but still higher than any debt burden prior to 2005.

FIGURE 2

Household debt relative to disposable income



Notes: Calculations based on Board of Governors, Federal Reserve System, "Release Z.1 Flow of Funds Accounts of the United States" (2010).

The relatively high debt burden of consumers will continue to slow economic growth below its potential and thus hold back employment growth for years to come.[10] Some simple simulations show that it will take years and possibly decades before household debt returns to sustainable levels (see Table 1). It will be March 2014 before household debt falls to sustainable levels under these best case assumptions. On the other end of the spectrum, a combination of slower income growth and faster debt growth will mean that debt either will never return to sustainable levels or that it will take three to four decades before households will get there on average. More realistically, after-tax income growth will receive a boost from new stimulus measures—discussed below—while lenders will remain reluctant to go back to old lending patterns for some time due to high default and foreclosure rates and new regulations, thus leading to the average scenario, under which it would take until December 2017 before debt falls to sustainable levels and no longer slows consumption growth.

TABLE 1

Time of household deleveraging necessary to reach sustainable levels of consumer debt under different assumptions

	After-tax income growth	Debt growth	Quarter when debt equals after tax income	Quarter sustainable debt levels—89.1 percent of after tax income—are reached
Historical				
Long-term (June 1953 to December 2007)	6.8	9.0		
December 2007 to September 2010	2.6	-1.0		
Assumed				
Low growth of debt burden (worst case)	5.0	4.0	March 2027	December 2038
Medium growth of debt burden (average)	6.0	2.0	December 2014	December 2017
High growth of debt burden (best case)	7.0	-1.0	December 2012	March 2014

Notes: All figures are in percent. Calculations are based on Board of Governors, Federal Reserve System, 2010, Release Z.1 Flow of Funds Accounts of the United States, Washington, DC: BOG.

The bottom line of these calculations is that consumers are clearly struggling with their debt. They are doing whatever is necessary to reduce their debt burden: repaying debt, defaulting on their credit cards, and letting banks foreclose on their homes. Even with these massive efforts, sustainable debt levels are years away. Consumption growth will stay subdued until then.

State budgets put a drain on economic and job growth

State and local governments have experienced atypically large and unusually long periods of budget deficits. State and local governments generally contributed positively to economic and job growth during the first year after a recession started, while budgets adjusted to the new economic realities.[11] Spending by state and local governments fell slightly during the recession with an average annual decline of -0.4 percent from December 2007 to June 2009.[12] But this decline accelerated to -1.1 percent from June 2009 to September 2010.[13] Analysts expect that state and local government spending will continue to decline in 2011 and 2012. The expected combined shortfall of state budgets alone, for instance, amount to an estimated $130 billion in 46 states for 2011.[14] And, a combined 40 states already project budget gaps of $113 billion for 2012.[15]

The crisis among state and local governments puts an added drag on total consumption as governments lay off many public employees. This is especially true for local governments, which employ more people than state governments and have cut back more aggressively than states. State employment was essentially unchanged between June 2009 and November 2010 as total employment there rose by only 6,000 jobs.[16] Local governments, in comparison, cut their employment by 337,000 jobs during that time.[17] These layoffs put added pressure on the private sector to create enough jobs to generate a strong, self-sustaining recovery. And, given the fiscal outlook for the states, it is unlikely that the current trends will be reversed any time soon.

Large trade deficits threaten private-sector recovery

The final challenge to a strong, self-sustaining recovery comes from the rising U.S. trade deficit. U.S. imports have grown faster again than U.S. exports since the end of the recession. The U.S. trade deficit rose from a low of 2.4 percent of gross domestic product (GDP) in June 2009 to 3.7 percent of GDP in September 2010.[18]

The rising trade deficit puts a drag on economic growth, particularly since private-sector firms are not selling as many goods as they otherwise would. Trade substantially detracted from economic growth in four out of the last five quarters.[19] Economic growth, for instance, would have been 1.8 percentage points faster in the third quarter of 2009 if it had not been for the widening trade deficit.[20]

It is unlikely that U.S. trade deficits will become smaller any time soon, thus continuing to put a drag on economic growth in the short term. U.S. exports have grown at comparatively strong rates as firms have been able to take advantage of a lower dollar and overseas growth.[21] There is little reason to believe that U.S. exports will grow more quickly in the near term. U.S. imports, on the other hand, have started to rise again and thus caused a widening of the trade deficit. U.S. imports of more petroleum goods due to higher oil prices, of more capital inputs, and more industrial supplies have been the primary drivers of the widening trade deficit.[22] Much of these imports are thus related to the surge in manufacturing and export activities, as U.S. producers purchase more of their inputs overseas.[23] U.S. trade deficits will likely continue to remain at substantial levels since the widening trade deficit is a reflection of accelerated imports and many U.S. imports are driven by resurgent U.S. growth in the United States.

Recovery will remain subdued

The recovery will remain weak for some time to come, primarily because households are overburdened by debt. Continued deleveraging that is not detrimental to economic growth will require much faster job and wage growth than we have seen in recent years. Fiscal problems among state and local governments, however, put the brakes on public sector employment growth. And, the rising U.S. trade deficits will limit private sector job growth in the near term. As the labor market will remain weak, private employers will have little incentive to increase their payrolls, furthering the weakness in the labor market. The U.S. economy and labor market are thus stuck in a slow growth recovery for the foreseeable future.

The Massachusetts experience subject to similar pattern of slow future

A closer look at the data for Massachusetts suggests that the local economy is also subject to a number of macro factors that slow its economic growth and will probably do so for some time. Massachusetts, though, is moving forward from a slightly better starting position than the average for other states. Economic and employment growth will thus lie potentially above the expected U.S. growth.

Massachusetts growth macro movements ahead of the curve in the recession

The growth experience of Massachusetts since the start of the last business cycle, after 2000, differs from the national economy in two ways (see Table 2). First, economic growth was generally weaker in the aggregate in Massachusetts during the last business cycle than for the country as a whole. Some of this difference can be explained by slower population growth. The differences in per capita growth were always smaller than the differences in aggregate growth. Still, the Massachusetts economy grew more slowly between 2002, the year after the last recession ended and 2006, the year, before the financial crisis hit.

Second, Massachusetts has grown faster during the crisis than the rest of the United States for three years in a row—2007, 2008, and 2009. It is largely a reflection of the fact that the downturn in the housing market occurred earlier in Massachusetts than in the rest of the country.

TABLE 2

Real economic growth, Massachusetts and the United States, 2001 to 2009

	Real GDP growth			Real per capita GDP growth		
Year	Massachusetts	United States	Difference (Massachusetts – United States)	Massachusetts	United States	Difference (Massachusetts – United States)
2001	2.4	1.3	1.1	1.6	0.2	1.4
2002	0.1	1.7	-1.6	-0.3	0.8	-1.1
2003	1.5	2.1	-0.6	1.3	1.3	0.0
2004	2.0	3.4	-1.4	2.0	2.5	-0.5
2005	1.1	2.8	-1.7	1.1	1.9	-0.8
2006	1.5	2.7	-1.2	1.3	1.7	-0.4
2007	2.0	2.1	-0.1	1.5	1.1	0.4
2008	1.2	0.1	1.1	0.5	-0.8	1.3
2009	-1.6	-2.1	0.5	-2.3	-2.9	0.6

Notes: All figures are in percent. Growth rates are based on real GDP in 2005 dollars. Source is Bureau of Economic Analysis, 2010, Gross Domestic Product by State, Washington, DC: BEA.

Massachusetts housing market ahead of the curve

Household debt will remain a burden to economic growth in the United States and in all likelihood in Massachusetts. Most household debt is held in the form of mortgages that were built up during the boom years. The data on the housing prices suggests that Massachusetts households built up a lot of debt, too, but that the deleveraging process possibly started earlier here than in other states (see Figure 2). First, the run up in house prices in Massachusetts was faster up to peak levels than was the case for the rest of the country. House prices in Massachusetts grew a total of 56 percent from March 2001 to December 2005, while the U.S. average house price rose only 52 percent over a longer period, from March 2001 to June 2007.[24] This suggests that households may have on average held more debt in Massachusetts than elsewhere, but this difference is in part explained by higher incomes. The average debt burden likely reached similar levels at the peak of the debt boom in Massachusetts than on average in the other states. Second, house prices peaked earlier in Massachusetts than for the rest of the country. House prices in Massachusetts reached their highest level in December 2005, while the rest of the country continued to experience gains through June 2007.[25] This implies that the mortgage boom slowed earlier in Massachusetts than elsewhere.

Third, house prices in Massachusetts have leveled off in 2010, while they continued to fall for much of the rest of the country (see Figure 3). The housing market hence puts less pressure on household finances since the number of households who are under water on their mortgages no longer rises, but it also adds little to economic growth since many homeowners remain under water.

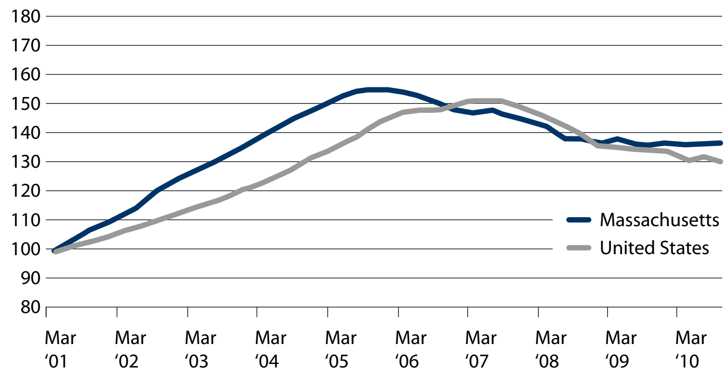
Massachusetts labor market exhibits continued weaknesses

The trends in the economy and the housing market are also reflected in the labor market. Massachusetts experienced a rise in the unemployment rate earlier than the rest of the country, but it also saw its unemployment rate decline sooner than has been the case for the rest of the country.

FIGURE 3

House price indexes, Massachusetts and United States

2001–2010, March 2001=100



Note: Calculations based on Federal Housing Finance Agency, "House Price Index" (2010).

The Massachusetts unemployment rate has also generally stayed lower than the national average.[26] The Massachusetts unemployment rate peaked at 9.5 percent in February 2010, compared to a high point of 10.1 percent nationally in October 2009.[27] The Massachusetts unemployment rate also fell more quickly, dropping 1.4 percentage points from February 2010 to October 2010, than the national unemployment rate, which decreased only 0.1 percentage points during the same time period.[28] The bottom line is that, going forward, Massachusetts consumers are in a slightly better position than consumers elsewhere, but that potentially high debt levels and comparatively high unemployment rates will continue to slow consumption growth here as they do in the rest of the country.

Massachusetts trade experience could burden recovery

Massachusetts has benefited from strong export growth in 2010, following a sharp decline in 2010. Exports have exhibited strong growth in Massachusetts through the summer of 2010.[29] This follows a decline in Massachusetts exports of $4.8 billion from 2008 to 2009.[30]

The positive export experience, though, may be offset by rising imports in Massachusetts. Massachusetts showed a trade deficit of $2.9 billion in 2009, following a deficit of $3.9 billion in 2008.[31] Much of the decline in the trade deficit was due to sharply lower imports of raw materials, natural gas and petroleum, due to a much weaker economy, and lower imports of industrial materials, due to less manufacturing and export activity in 2009.[32] As the economy, manufacturing, and exports in Massachusetts rise, so will Massachusetts imports. It is likely that this growth will be associated with a widening trade deficit since Massachusetts imports will grow from a larger basis than Massachusetts exports. Trade will, similar to the United States trend, slow private-sector growth.

Going forward, Massachusetts cannot save itself

The performance of the Massachusetts economy looks only relatively good when compared to many other parts of the country that struggle even more. The economy is still weak by absolute standard. The economic recovery in Massachusetts will stay subpar unless the national economy moves to a stronger, self-sustained recovery because the Massachusetts economy is burdened by similar obstacles to faster growth than the U.S. economy. The national economy, though, suffers from several obstacles to accelerated growth. That is, much of the future outlook for the U.S. economy and for the Massachusetts economy will depend on the success of economic policy measures that are intended to foster stronger growth.

Growth and unemployment projections for Massachusetts, absent additional policy interventions reflect similar slow growth patterns as are expected for the United States (see Table 3). Growth is expected to be somewhat faster and the unemployment rate slightly lower in Massachusetts than in the rest of the country in 2011, but the two are forecast to move closely together for the medium term. This simply reflects the fact that both the Massachusetts economy and the national economy are held back by similar macro economic trends.

TABLE 3

Growth and employment projections, Massachusetts and the United States, 2010-2013

	2010	2011	2012	2013
U.S. growth (current dollars)	2.7	3.1	5.0	4.2
Massachusetts growth (current dollars)	2.7	3.5	4.9	3.8
U.S. unemployment rate	9.7	9.9	8.3	6.5
Massachusetts unemployment rate	9.2	9.4	8.2	6.5

Notes: All figures are in percent. Author's calculations based on Moody's Analytics, 2010, United States, précis U.S. state, Northeast, September, West Chester, PA: Moody's Analytics, and Moody's Analytics, 2010, Massachusetts, précis U.S. state, Northeast, September, West Chester, PA: Moody's Analytics.

Federal policy interventions are ongoing efforts with changing focus

The federal government has enacted a series of policies to set the economy on a path to a recovery from the worst recession since the Great Depression and to avoid a prolonged slow growth pattern with unusually high unemployment rates. The largest economic stabilization measure to date was the American Recovery and Reinvestment Act of 2009 (ARRA). Congress is currently considering additional temporary measures targeted towards strengthening the economic recovery through a bipartisan tax deal reached between President Obama and the Republican leadership in Congress.

ARRA's three-pronged approach

Congress enacted a series of spending and tax measures totaling an estimated $787 billion. ARRA made available $288 billion in tax cuts, $275 billion for contracts, and $224 billion in additional entitlement spending. Massachusetts was slated to receive an estimated $6.7 billion in economic stimulus from ARRA.[33] Tax cuts included tax credits, for instance, for employed workers, but also a fix to the alternative minimum tax, so that the tax would not adversely impact a larger share of taxpayers during the recession. More money for contracts went towards a wide range of potential projects, such as energy efficiency, green technologies, improved roads and bridges, rail transportation, among many others. And, entitlements included extended and increased unemployment benefits, higher Social Security benefits, and support to states for health care spending.

ARRA reflected a three-pronged approach to stimulate the economy. These included extended and increased unemployment, higher Social Security benefits, and tax credits for employed workers at the personal level to increase personal consumption. It also included new spending on infrastructure projects, particularly for green technologies and energy efficiency measures, to boost construction and manufacturing in the private sector. Additionally, ARRA included funds for state and local governments, targeted towards education and health care, to ease the strains of the recession on state and local budgets. The stimulus package was thus intended to address the weaknesses in the three domestic sectors of the economy—consumption, business investment, and state and local government finances.

The funds were intended to be spread out over a number of years, with the bulk being spent in 2009 and 2010. Support for consumers and states made up the lion's share in 2009, while the focus increasingly shifted to project spending over time.[34]

The Middle Class Tax Relief Act of 2010 narrows focus, limits future options

The economy has turned from major recession to recovery, but not yet to a strong, self-sustaining recovery, as the discussion in the previous sections made clear. Federal policymakers concluded that additional stabilization measures may be necessary. Moreover, tax cuts enacted during President Bush's administration were scheduled to expire on December 31, 2010. President Obama and the Republican congressional leadership reached an agreement that, if enacted, would combine a temporary extension of the Bush era tax cuts with a series of other tax measures. The agreement has been introduced in Congress as the Middle Class Tax Relief Act of 2010.

The bipartisan tax agreement, as initially described, breaks down as follows for the next two years (see Table 4).[35] The single largest item is the extension of the personal tax cuts enacted between 2001 and 2003. The estimated cost for the extension of the tax cuts for people making less than $250,000 amounts to $360 billion for 2011 and 2012, and the extension of the tax cuts for higher-income earners totals $120 billion. The total extension of these tax cuts thus makes up almost half, $480 billion out of $967 billion, of the estimated two-year cost of the bipartisan agreement. A deal on the estate tax to raise the exemption amount and reduce the tax rate cost an additional estimated $13 billion. Another $120 billion are dedicated to a payroll tax holiday for employees, which will reduce the Social Security tax for employees from 6.2 percent of earnings to 4.2 percent of earnings for one year. Further, the continuation of extended unemployment insurance benefits through 2011 and the extension of an improved Earned Income Tax Credit and Child Care Credit total $94 billion. The remaining benefits of the bipartisan agreement accrue to businesses in the form of extended tax breaks, such as additional R&D tax credits, and rules that allow faster expensing of capital goods than is the case under the tax code.

The bipartisan tax agreement consequently marks a shift in the focus of federal short-term interventions in the economy. Benefits to individuals, primarily in the form of lower taxes, amount to a combined total of $707 billion, or 73.1 percent of the total cost for the next two years. The bipartisan agreement thus shifts the focus away from an emphasis on all three struggling domestic sectors towards a much larger emphasis on the consumer. The bipartisan tax agreement, for instance, includes no assistance to struggling states and localities.

TABLE 4

The estimated cost of the bipartisan tax agreement for two years

Measure	Estimated size
Tax cuts for top income earners	120
Payroll tax cut	120
Business extenders	80
100% expensing/Bonus depreciation	180
Refundable low-income credits	38
Unemployment insurance extension	56
Broad based tax cuts	360
Estate tax	13
Total	**967**

Notes: All figures are in billions of dollars.
Source: Ettlinger, M., and Linden, M., 2010, Tax and unemployment agreement leads to jobs growth, Washington, DC: Center for American Progress.

The bipartisan tax agreement is expected to add to economic and job growth in 2011 and beyond due to the boost to consumer spending. Importantly, though, not all provisions of the agreement will change the outlook for economic growth. Most forecasters expected a large share of the agreement to pass anyway. This is especially true for the extensions of tax cuts for lower-income and middle-income families since there was no political disagreement over these extensions. The added growth effect projected as a result of the bipartisan tax agreement consequently only reflects the separate agreements, such as continuation of extended unemployment insurance benefit and the extension of the 2001 and 2003 tax cuts for high-income earners. Economic forecasters generally expect that economic growth will be about one percentage point higher in 2011 than it would have been without the tax agreement (see Table 5).

TABLE 5

Select growth projections with and without the bipartisan tax agreement

	GDP growth projection with tax agreement (in 2011)	GDP growth projection without tax agreement (in 2011)
PIMCO	+ 3-3.5%	+ 2-2.5%
Goldman Sachs	+ 3.2-3.7%	+ 2.7%
Economy.com (Zandi)	+ 3.9%	+ 2.8%

Source: Alban, J., 2010, PIMCO ups U.S. economic growth forecast on tax deal, New York, NY: Reuters, December 9; Leonhardt, D., 2010, Zandi on the 2012 problem, Exonomix blog, New York Times, December 10.

The added benefit will gradually diminish over time. Several of the added measures are scheduled to expire at the end of 2011. This is true for the continuation of extended unemployment insurance benefits and the payroll tax holiday, which make up the bulk of added growth effect from the bipartisan tax agreement.[36] But, it will take some time before all of the measures potentially enacted for 2011 will impact the economy. Consumers will get a boost to their income in 2011, but will spend some of the additional income in 2012. The boost to economic growth in 2012 will still be positive, but likely smaller than in 2011. The hope is that these effects together will be strong enough to create a strong, self-sustaining recovery in 2011 and beyond.

Additional economic stimulus measures beyond the bipartisan tax agreement will likely be comparatively small. The bipartisan tax agreement will add to the existing U.S. federal budget deficits. These continued and large deficits will constrain the ability of policymakers to design additional policy measures to strengthen the economic recovery beyond 2011 and 2012.

The bipartisan tax agreement and its implications for Massachusetts

There are no specific estimates available yet for the potential effect of the bipartisan tax agreement on expected growth in Massachusetts. It seems reasonable that the combined effect of the bipartisan tax deal will add about one percentage point to expected economic growth for 2011 and somewhat less in 2012.

A percentage point increase in economic growth, beyond what has been already forecast, will likely be the upper end of the economic effect from the bipartisan tax deal. This follows from several considerations. First, the continuation of the tax cuts enacted in 2001 and 2003 for tax payers earning less than $250,000 is likely already reflected in existing growth forecasts since there was no policy disagreement over the extension of these tax cuts. Much of the tax agreement thus will not lead to faster growth expectations.

Third, the continuation of extended unemployment insurance benefits is the measure among the parts of the bipartisan tax agreement that are expected to have the strongest added growth and employment effects. But, the Massachusetts unemployment rate is already below the national average and is expected to remain below it in 2011, meaning that proportionately fewer people in Massachusetts than in the rest of the country will benefit from extended unemployment insurance benefits. This is offset by the fact that the average weekly unemployment insurance benefit amount is higher in Massachusetts than the national average, $392 compared to $303 in October 2010.[37] The higher benefit amount will thus likely offset the effect of a lower unemployment rate, so that Massachusetts will benefit proportionately from this provision, but not receive an extra boost from the most efficient part of the tax deal.

Third, most public employees in Massachusetts contribute to state and local government retirement plans instead of Social Security. They consequently will not receive the benefits from the payroll tax holiday. The lost stimulus to the Massachusetts economy amounts to more than $300 million.[38]

Consequently, it seems likely that the bipartisan tax agreement will have the same or potentially a slightly smaller impact in Massachusetts than is estimated for the national economy on average. Economic growth will thus increase by about one percentage point over forecast.

Conclusion

Economic growth in the United States does not yet seem strong enough to generate a strong, self-sustaining recovery that will lead to substantially lower unemployment rates in the near term.

The Massachusetts economy is ahead of the curve, having gone through several months of substantially declining unemployment rates. Continued momentum in the Massachusetts economy and the Massachusetts labor market, though, will depend to a large degree on a stronger U.S. economy.

Additional public policy interventions, particularly through the new Middle Class Tax Relief Act of 2010, could add as much as one percentage point to economic growth for the United States and Massachusetts.

It remains an open question as to whether the additional economic stimulus will be enough to create a strong, self-sustaining economic recovery in 2011 and beyond, when many of the new policy measures will expire. That is, economic activity will be larger and unemployment will be lower than they would have been without the new stimulus in 2011 and 2012, but additional decreases in unemployment and more gains in income may again slow somewhat after 2012.

Endnotes

1 National Bureau of Economic Research, "Announcement of June 2009 Business Cycle Trough/End of Last Recession" (2010).

2 Bureau of Economic Analysis, "National Income and Product Accounts" (2010).

3 Ibid.

4 Bureau of Labor Statistics, "Current Population Survey" (2010).

5 Bureau of Labor Statistics, "Current Employment Statistics" (2010).

6 Bureau of Economic Analysis, "National Income and Product Accounts."

7 Ibid.

8 Ibid.

9 Ibid.

10 The calculations use the following assumptions. First, a reasonable assumption may be the average debt level—debt to after tax income—that persisted during the second half of the business cycle of the 1990s, from December 1994 to March 2001. Many financial market changes that helped to increase debt—deregulation, financial innovation, and lower interest rates—were already in place and still characterize the economy now. This would imply that a ratio of 89.1 percent or lower of debt to after-tax income would be sustainable. Second, after-tax income growth has generally been stable. It has typically not risen by more than an annual average of seven percent during a decade—outside of high inflation periods. The slowest income growth during any ten year period fell a little below an annual average of five percent. The simulation consequently assumes that after-tax income will grow by five percent, six percent, or seven percent going forward. Debt has traditionally gone up, but we are clearly in a new world of unsustainable debt levels. It is thus likely that, at least for the foreseeable future, debt will grow more slowly than in the past. How much slower debt will grow in the near future will depend on several factors, such as financial market regulation, interest rates, and level of foreclosures. It is highly unlikely, though, that debt will fall any faster than it has in the past two years, when it declined at an annual rate of -1 percent. The simulations thus assume possible debt growth of 4 percent, 3 percent, and -1 percent.

11 Christian Weller, "Government Spending Helps Slow Economic Freefall" (Washington: Center for American Progress, 2009).

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24 Federal Housing Finance Agency, "House Price Index" (2010).

25 Federal Housing Finance Agency, "House Price Index" (2010).

26 The discussion here centers on the unemployment rate as an indicator for movement towards a strong recovery. The employment trends for Massachusetts and for the United States show similar differences.

27 Bureau of Labor Statistics, "Current Population Survey" (2010).

28 Bureau of Labor Statistics, "Current Population Survey."

29 A. Clayton-Matthews, "Current and Leading Indicators for Massachusetts" (Boston: New England Economic Partnership, 2010).

30 U.S. Census Bureau, "State Exports for Massachusetts" (2010).

31 U.S. Census Bureau, "State Exports for Massachusetts."

32 U.S. Census Bureau, "State Exports for Massachusetts."

33 "State/Territory Summary – Massachusetts" Recovery.gov,, available at http://www.recovery.gov/Transparency/RecipientReportedData/Pages/statesummary.aspx?StateCode=MA (last accessed December 2010).

34 Congressional Budget Office, "H.R. 1 American Recovery and Reinvestment Act, Cost Estimate" (2009)..

35 These estimates differ from other estimates largely because of the time frame under consideration. The longer-term costs of faster business expensing in particular are expected to be much lower if the time frame is extended beyond the initial two years. Businesses that use accelerated expensing in the first two years of expenditures will have fewer opportunities to expense their purchase and thus will pay higher taxes in subsequent years. See Joint Committee on Taxation, "Estimated Revenue Effects of the House Amendment to the State Amendment to H.R. 4853, The 'Middle Class Tax Relief Act of 2010'" (2010).

36 Michael Ettlinger and Michael Linden, "Tax and Unemployment Agreement Leads to Jobs Growth" (Washington: Center for American Progress, 2010).

37 U.S. Department of Labor, "State UI Data Program Data – Monthly Program and Financial Data" (2010)..

38 This estimate is arrived as follows. Massachusetts payroll for state and local government employees in 2009 was approximately $1.5 billion in March 2009. It is then estimated that the payroll will stay constant through 2011. Furthermore, it seems reasonable that 90 percent of this payroll would be subject to Social Security taxation if public employees contributed to Social Security instead of their state and local government retirement plans. Not all earnings are subject to Social Security taxation due to a cap on individual earnings that are subject to taxation, currently at $106,800. Monthly potential taxable payroll thus amounts to about $1.4 billion. A two percentage point tax cut for one year then totals $334 million. For more details see U.S. Census Bureau, "Government Employment and Payroll" (2010).