

**Presentation by Lauritz Mills
Director, Bureau of Economic Research**

Office of the Governor

Before the Committee of the Whole

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Economic Impact of the American Recovery and Reinvestment Act of 2009

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Earle B. Ottley Legislative Hall

10:00 A.M.

Introduction

Good morning, Mr. Chairman and members of the 28th Legislature Committee on the Whole. I am Lauritz Mills, Director of the Bureau of Economic Research. I will speak briefly on the potential economic impact of some provisions of the American Recovery and Reinvestment Act, 2009. Before I do so, I would like to first give a snapshot of current economic conditions, which underscore the need for the use of the fiscal stimulus to support a flagging economy.

Economic backdrop

The need for a fiscal stimulus grows more pressing as the financial and economic picture of the Territory grows bleaker. Economic indicators have worsened, in parallel with a deepening of recessionary conditions in the US and a downturn in global economies. Private consumption expenditure has continued to slide, business investments have declined, and nonfarm payroll employment has been slipping. The deterioration in economic activity is spread across all sectors, although some have fared better than others. Construction, which has driven private-sector employment growth in the past few years, experienced negative growth rate of 4.5 percent in fiscal year 2008; the trade sector, particularly wholesale trade, experienced employment decline of 3.1 percent; the other services sector declined by 3.2 percent and the information sector experienced job loss of 2.6 percent. Job growth in the other sectors was either flat or negative.

Consistent with weakening labor market conditions, initial claims for unemployment insurance, one of the best leading indicators of future labor market conditions, have been trending upwards since April 2008, with a marked acceleration since September 2008. Claims spiked to 607 last September, the

highest in the past 3 years. These claims were representative of layoffs in construction, leisure and hospitality, cutbacks in oil refinery contract workers, and a decline in productivity hours. Although unemployment claims declined from the September peak, claims have averaged 326 during the first quarter of this fiscal year.

Recessionary conditions are likely to intensify in the ensuing months, thereby creating further erosion in the economy. The softening in tourism output, weaker consumer demand, lower construction activity, and contraction in employment underscore the deepening downturn in economic activity in most sectors of the economy. The deteriorating economic outlook and weakening demand, indubitably will continue to dampen income and spending in the months ahead, thus impacting the Territorial government revenues. Tax revenues are projected to decline, with expectations for slowing withholding tax receipts as unemployment rises, reductions in estimated personal income, a drop in corporate income as profits decline, and lower gross receipts from slowing consumers spending.

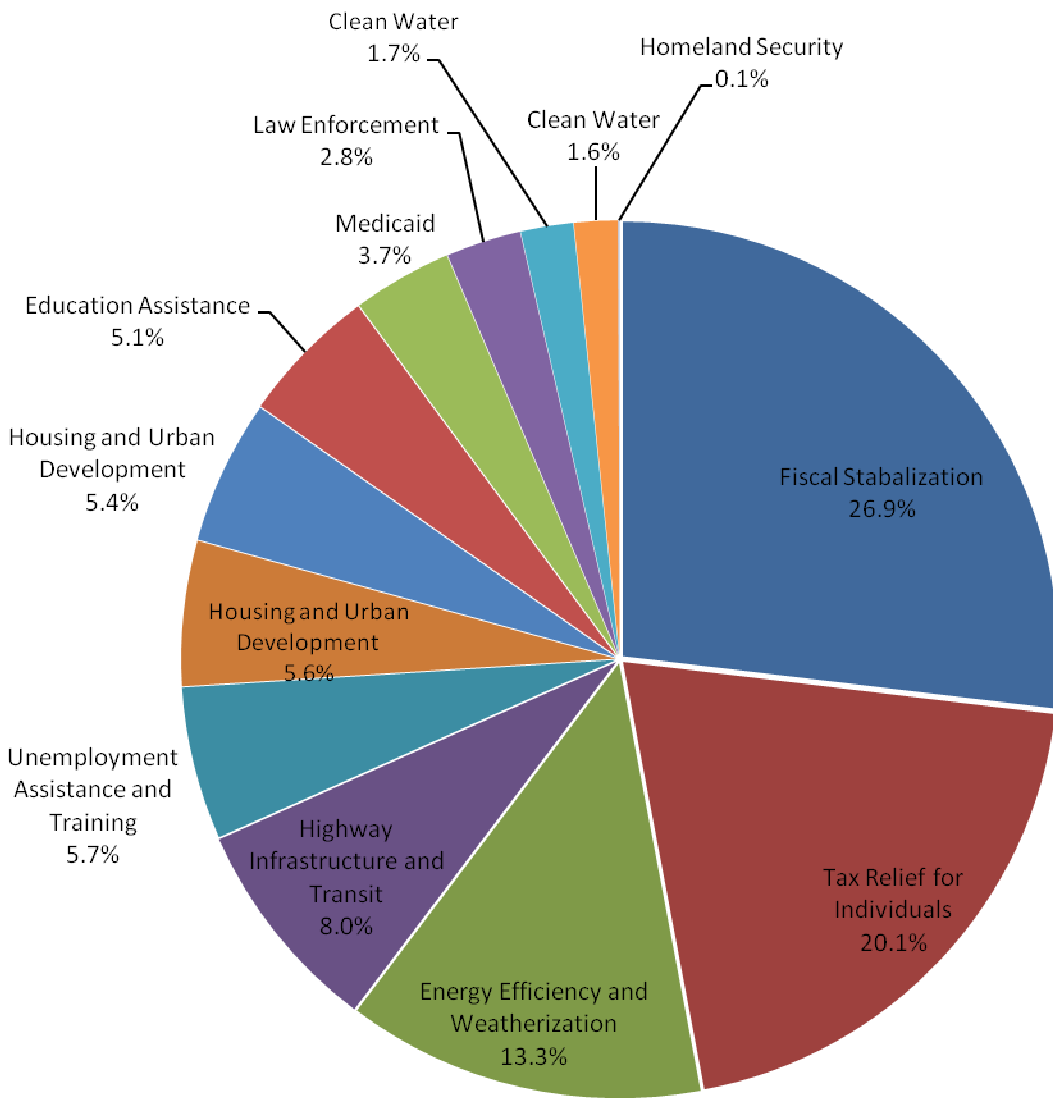
The American Recovery and Reinvestment Act of 2009

The American Recovery and Reinvestment Act (ARRA) of 2009, a nationwide stimulus effort that is designed to create jobs and jumpstart economic growth, is the first step towards economic recovery. The US government is spending nearly \$800 billion to put people to work on projects in all sectors of the economy, provide tax relief, improve the infrastructure, help states with severe budget deficits, and invest in energy independence. The Territory will be the recipient of at least \$248.9 million from the Stimulus Act. The larger provisions include \$67 million (26.9%) for fiscal stabilization, \$50 million (20.1%) for tax relief, \$33.1 million (13.3%) for Energy Efficiency and Weatherization, and \$20 million (8.0%)

for Highway Infrastructure and Transit. Other provisions include an expansion of food stamps, Medicaid and unemployment benefits, funding for education and workforce training, increased spending on health care, housing, and law enforcement. These details are shown in the table on below and are graphically represented on the next page.

Major Provisions in the ARRA 2009: US Virgin Islands		
Program	USVI Estimated Stimulus Dollars	Percent Share
Total	\$ 248,917,432	100.0
Fiscal Stabalization	\$ 67,000,000	26.9
Tax Relief for Individuals	\$ 50,000,000	20.1
Energy Efficiency and Weatherization	\$ 33,063,000	13.3
Highway Infrastructure and Transit	\$ 19,979,112	8.0
Unemployment Assistance and Training	\$ 14,127,143	5.7
Food & Nutrition	\$ 13,420,329	5.4
Housing and Urban Development	\$ 13,361,284	5.4
Education Assistance	\$ 12,771,605	5.1
Medicaid	\$ 9,193,500	3.7
Law Enforcement	\$ 6,944,159	2.8
Child Care	\$ 4,857,000	2.0
Clean Water	\$ 4,061,700	1.6
Homeland Security	\$ 138,600	0.1

American Recovery and Reinvestment Act, 2009



Economic Impact of Stimulus

Estimating the aggregate effects of the American Recovery and Reinvestment Act of 2009 is a daunting task, especially when much of the programmatic and spending details are not finalized. We submit, therefore, that the estimates of economic impact presented are based on incomplete information for the reason previously stated and are subject to error. This is the obvious uncertainty that comes from modeling a stimulus package with imprecise details.

Nevertheless, we have attempted to estimate the impact of the stimulus on economic output and employment by employing fiscal multipliers derived by leading economists. According to Mark Zandi, chief economist for Moody's Economy.com, stimulus efforts of this type provide substantial economic "bang for the buck." Fiscal relief to state and local governments results in \$1.38 in economic activity per dollar invested. Likewise, increased funds for food stamps, unemployment benefits and infrastructure projects produce \$1.73, \$1.64 and \$1.59, respectively, in economic activity per dollar invested. These multipliers may be slightly lower for the Territory, but their use is warranted for the purpose intended.

Economic multipliers are used to estimate economy-wide impacts of industry-specific economic changes. Each multiplier can be thought of as an empirical, quantified measurement of the strength of the economic linkages between a given industry or activity and the rest of the economy. The greater the multiplier, the greater the economy-wide dollar or employment impact of any given stimulus will be. To put it simply, the injection of new dollars into the economy has a measureable effect on economic activity, wages and jobs. The new dollars pass

from one person to another in successive rounds of spending, generating additional economic activity, jobs and wages that would not otherwise be produced. This is what is referred to as the multiplier effect.

For purposes of this analysis and to illustrate economic impact, we selected those categories where there seem to be a strong degree of agreement in terms of allocation and use of funds. Our analysis assumes about \$50 million in the form of tax relief, \$32.8 million in transfers or income support to individuals, and \$32.1 million for infrastructure spending, for a total of \$114.9 million. These categories of spending are by no means the only areas that will generate economic impact, but these tend to have a relatively large effect on output or gross territorial product (GTP) and employment.

A payroll tax credit is a particularly effective way of stimulating the economy as the benefit will go to the lower and middle income households. These households are more likely to spend any tax benefits they receive. In addition, tax relief can be implemented quickly, thereby providing a boost to the economy in a relatively short period of time. Income support in the form of unemployment insurance benefits, food stamps, and Medicaid is another effective way of priming the economy. The advantage here is that these programs are already in existence and can quickly deliver the increased benefits to recipients. Those who receive these benefits are likely to quickly spend any financial aid they receive. Finally, infrastructure spending is one of the most effective ways of stimulating the economy. The boost to economic output for spending on roads, construction projects etc. is large. But the impact is not as immediate as tax relief and income support, since the planning and implementation of capital projects take some time, even with shovel-ready projects. To the extent possible, therefore, we must move

with deliberate haste to get projects implemented so that the economy can begin to reap the benefits.

Our analysis projects that approximately \$115 million in stimulus spending for these three categories will generate a cumulative impact on economic output of about \$155 million over two years--\$52.5 million from income support, \$51.5 million from tax relief, and \$51 million from infrastructure spending. A total of 1,170 jobs will be created over two years. These impacts are presented in the table below.

Economic Impact of Selected Provisions in the ARRA 2009: US Virgin Islands				
Categories	USVI Estimated Stimulus Dollars	GTP Multipliers	Total Impact on GTP	Job Creation
Government Spending	114,870,113		154,917,821	1,170
Income Support	32,813,829		52,448,329	394
Food Stamps	13,420,329	1.73	23,217,169	
Unemployment Insurance	2,909,637	1.64	4,771,805	
Medicaid	9,193,500	1.36	12,503,160	
Infrastructure Spending	32,056,284	1.59	50,969,492	386
Highway	18,695,000			
Housing	13,361,284			
Tax Relief	50,000,000	1.03	51,500,000	390

Conclusion

These numbers underscore the tremendous impact a stimulus of this type can have on the economy. Whatever policy decisions we make over the next several weeks will determine whether our economy continues to slide and whether people will lose their jobs.