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# The Role Government Should Play in the American Recovery and Reinvestment Act 2009

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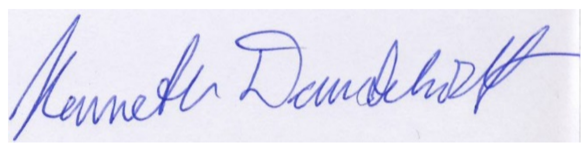

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# THE ROLE GOVERNMENT SHOULD PLAY IN THE AMERICAN RECOVERY AND REINVESTMENT ACT 2009

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## I. Introduction

What role should the government play in administering economic stimulation acts such as the American Recovery and Reinvestment Act 2009 (ARRA)[1] in response to a harsh economic situation? Should the government continue its previous direction of regulation that allows the government's active intervention in the market even at this point of time that the Obama administration is facing for the second term?

The purpose of this research is to determine the most effective way to administer an economic stimulation act and what role the government should play. More specifically, the paper will discuss administrative problems and limitations, such as the government's possible disengagement[2] from the real market stake holders' assessment in the ARRA and will provide possible solutions to eliminate or minimize those defects. Ultimately, the research seeks to satisfy the real market stake holders' expectation by analyzing the pros and cons of the ARRA, and by comparing Korea's administrative approach to adopting an economic stimulation plan in the real market with the overall goal of narrowing the gap between legal policy and market reality.

The current economic problems are considered to have created the most serious global economic crisis since the 1930s. President Roosevelt created the New Deal to alleviate the Great

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[1] *See generally* American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 3, 123 Stat. 115, 115-16 (2009) (Being intended "[t]o preserve and create jobs and promote economic recovery"; "assist those most impacted by the recession"; "provide investments needed to increase economic efficiency": "invest in transportation, environmental protection, and other infrastructure that will provide long-term economic benefits"; and "stabilize State and local government budgets, in order to minimize and avoid reductions in essential services and counterproductive state and local tax increases.")

[2] *See, e.g.*, Ben Bernanke, *The Fed's Exit Strategy, Op-ed*, Wall St. J. L. (Jul. 21, 2009) (the Federal Reserve had identified some positive signals of recovery with a policy package of so-called exit strategy, even though the market still felt the suffering of recession), http://online.wsj.com/article/SB10001424052970203946904574300050657897992.html.

Depression of the 1930's. What role should the current government play in solving the current economic situation?

The Congressional Budget Office's announcement of economic indicators shows signs of economic recovery in the U.S.[3] However, numerous mid-to-small sized companies and households have not yet to see much relief. To identify the role of government, to find out the proper direction of regulations, and to narrow down the government disengagement from the real market; this research mainly will evaluate the assessment of the ARRA 2009. To accomplish the research, this thesis will consist of five sections including the introduction as section I.

In section II, this paper I will present an historical analysis as one of the key assessment tools. There is no more urgent time than now to reach for a new legal theory and scholarly agenda, because neither simple legal doctrine nor simple economics will solve the grave problem facing us. Thus, following the historical steps for the development of an economic depression will show the strengths and weaknesses of the government's approach regarding the regulations. By addressing legal theoretical history and background, I will discuss the overall goal of this thesis in determining the proper role for government to play.

In section III of this paper I will assess the ARRA. Specifically, I will look into the legislative history[4] of the ARRA to analyze the pros and cons of the Act and how the Democratic and Republican Parties approached the Act[5]. The Obama administration insists that more regulatory restrictions are needed to normalize the market, which has a theoretical basis in

[3] Felix Reichling and Charles Whalen, *Assessing the Short-Term Effects on Output of Changes in Federal Policies*, Congressional Budget Office Working Paper 2012-08 (May 2012).

[4] 2009 Legis. Bill Hist. US S.B. 1298.

[5] 155 CONG. REC. H 10436.

Keynesian economic theory[6]. Alternatively, the Republican view is that the government should remove restrictions and let the market stand up by itself[7]. The analysis between these opposing sides of political and theoretical voices will support the ARRA and will show that the government should have some power to control the market effectively.

In section IV of this paper I will compare the governments' interpretation of different stimulus Acts in the U.S. and South Korea. To study the lessons from the earlier Asian financial crisis, research on Korea is significant because not only is Korea the only country that successfully recovered from the late 1990s recession, but the Korean government also applied the stimulus Acts differently, even though it used mainly the same economic stimulation approaches, such as increasing government expenditure and reducing taxes. The Korean government included with their stimulus spending specific orders to maintain control over the markets. Thus, the comparisons will examine whether more government involvement in the ARRA encouraged further intrusion of the ARRA 2009 into the real market. Also it includes a comparison of the government's economic stimulation regulatory methods in both the U.S. and South Korea. This comparison is significant because legal trends tend to cycle over time between the world and legal institutions. Also, analysis of economics and history is essential to understand law's actual operation—its failures and successes.

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[6] *See. e.g.,* Jonatan Weisman & Jess Bravin, *Obama's Regulatory Czar Likely to Set a New Tone,* Wall St. J. L. (Jul. 8, 2009) (President Obama appointed Cass Robert Sunstein, a self-designated new legal realist and proponent of the incorporation of behavioral law and economic insights into policymaking, to head the Office of Information and Regulatory Affairs (OIRA). OIRA is responsible for reviewing all agency draft regulations before they are published to ensure that they comply with the President's Executive Order for regulatory policymaking. It is very much in line with Keynesian school of economic theory.), http://online.wsj.com/article/SB123138051682263203.html.

[7] See. Jeffrey Miron, *Romney's Economic Plan Has the Edge*, CNN Online, (Oct. 18, 2012), http://www.cnn.com/2012/10/18/opinion/miron-romney-economic-plan/index.html.

In section V of this paper I will state my conclusion. I examine how government regulations should apply in the real market, thus acquiring meaning and having effects through internal business policies and procedures. Moreover, I will examine how these approaches suggest that we shouldshape future stimulation acts more efficiently to provide a more realistic regulatory outcome to stimulate economics effectively. In order to assess the role of law within the executive branch under the economic recession, there must be a comprehensive review of major economic stimulation acts and regulatory approaches that authorize the executive branch to exercise its discretionary power. Then, such laws and regulations, as well as legal institutions, should be transformed to a market-allocative and a rule-based legal system.

## II. An Historical Inquiry, Comparison the Great Depression and Great Recession

### 1. The Great Depression of the 1930’s

### A. Historical Background and General Definition of the Great Depression

The 20th century’s most severe economic downturn was the Great Depression. The time period of the Great Depression was varied to each country but most of world suffered a harsh economic downturn during the 1930s through the middle 1940s.[8] It also was the decade before World War II.

There are various views about the start of the Great Depression, but the general consensus is that the starting point was the U.S's stock market meltdown. It was the origin of the Great Depression and it created the worldwide stock market crash in late 1929.[9] For specific examples, international trade decreased more than 50%, and U.S.'s unemployment rate rose up to 25%, while other counties showed unemployment rates of more than 33%.[10] In the U.S., by 1933, the nations' gross domestic product had dropped by a third. The seriousness of this economic calamity shook the American people's confidence in capitalism.[11] The following chart and table show the decrease of the U.S. GDP and employment rates at that period of time.

[8] *See Generally* John A. Garraty, *The Great Depression* (1986).

[9] *See. e.g., Depression & WWII (1929-1945),* AMERICAS LIBRARY (Jan. 29, 2013, 10:05 PM) (the depression originated in the U.S., after the fall in stock prices that began around September 4, 1929, and become worldwide news with the stock market crash of October 29, 1929, that is known as Black Tuesday.), http://www.americaslibrary.gov/jb/wwii/jb_wwii_subj.html.

[10] ROBERT H. FRANK & BEN S. BERNANKE, PRINCIPLES OF MACROECONOMICS 98 (3rd ed. 2007).

[11] *See generally* JOHN KENNETH GALBRAITH, THE AGE OF UNCERTAINTY (1977); *See also* JOHN KENNETH GALBRAITH, THE GREAT CRASH 1929 (1997).

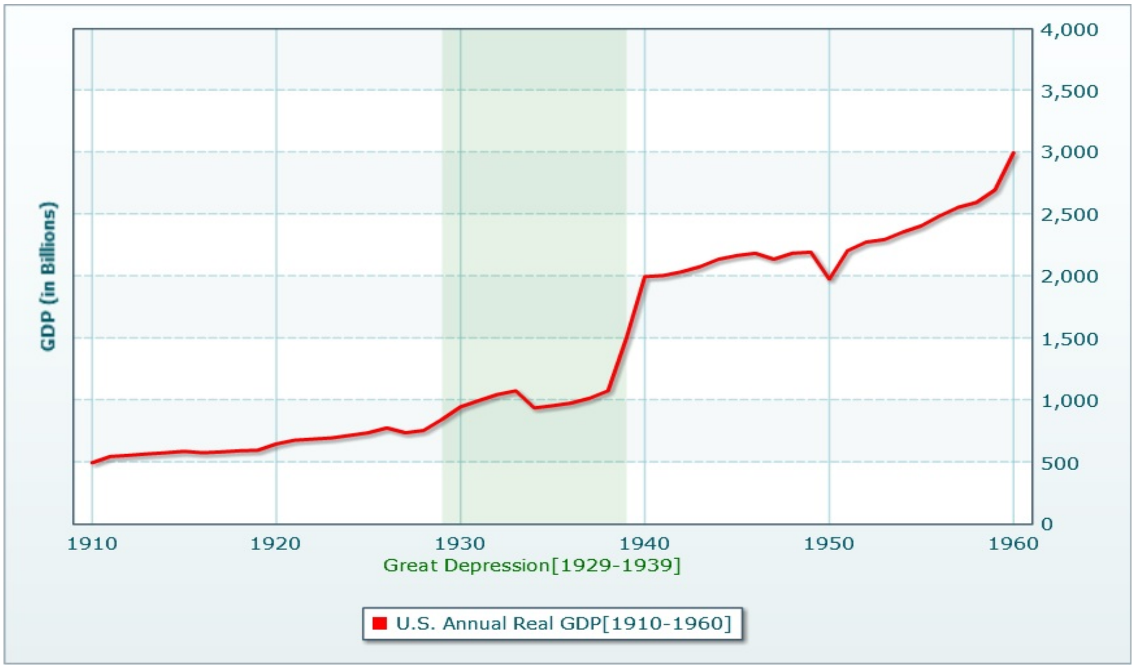


*Figure 1. U.S.A annual GDP from 1910~1960 (The years of the Great Depression:1929~1939)*[12]

[12] CURRENTS OF CHANGE, ENGAGING SOCIAL STUDIES ACTIVITIES THAT MEET STATE CURRICULUM STANDARDS, (Gross domestic product, or GDP, is the monetary value of all the goods and services produced by an economy during a specific period, including consumption, government purchases, investments, and exports minus imports. In the graph above, you can see how our GDP stalled during the Great Depression of the 1930s, then quickly increased by the end of the decade, and continued to grow at a more steady pace up to 1960), http://currentsofchange.net/map/annual-gdp/ (last visited Oct. 6. 2013).

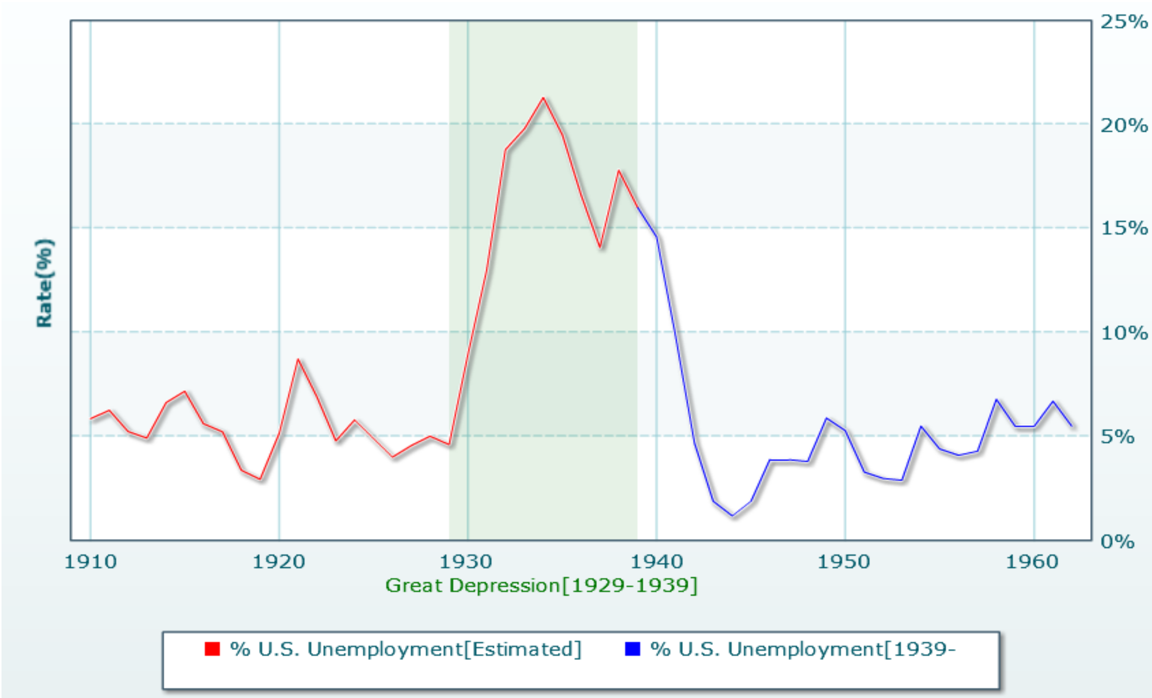


*Figure 2. U.S.A's unemployment rate (The years of the Great Depression:1929~1939)*[13]

## B. The Causes of the Great Depression

### 1. Monetarist Theories

There are several views about the main causes of the Great Depression. Monetarist economists insisted that the main causes were the U.S. Federal reserve's failure to maintain the money supply, and Britain's returning to the gold standard. Meanwhile, economic historians

[13] *Id. See also* STANLEY LEBERGOTT, THE MEASUREMENT AND BEHAVIOR OF UNEMPLOYMENT 215-216 (Universities-National Bureau ed., The National Bureau of Economic Research. 1957). The 1937 average was 7.7 million and the 1938, 10.4. Since November was at the end of a recession beginning in June, one would expect the November figure to be somewhere between 7.7 and 10.4- perhaps about 9 million.

insisted that the causes were both the structural weakness and specific events, such as major bank failures and the U.S stock market's devastating collapse on October 29, 1929.[14]

The monetarists insist that the Federal Reserve's failure of increase the money supply to compensate for the collapse of the money supply caused by bank failures caused a reduction of the money supply that exacerbated the economic situation, and it caused a recession to descend into the Great Depression. For instance, the failure of the New York Bank of the United States that produced the chain reaction of panic and widespread runs on local banks is one of examples that shows the Federal Reserve's failure of monetary policy.[15] The Federal Reserve allowed the large public bank failure; they sat idly by while the banks collapsed. One of the monetarists Milton Friedman also argued that, if the Federal Reserve had provided emergency lending to these key banks, or simply bought government bonds on the open market to provide liquidity and increase the quantity of money after the key banks fell, all the rest of the banks would not have fallen after the large ones did, and the money supply would not have fallen as far and as fast as it did.[16]

In addition, the timing issues of the regulation was one of the significant reasons why the Federal Reserve could not limit the decline of the money supply. According to the information by The American Presidency Project, at that time the amount of credit the Federal Reserve could issue was limited by the Federal Reserve Act, which required 40% gold backing of Federal Reserve Notes issued.[17] By the late 1920s, the Federal Reserve had almost hit the limit of allowable credit

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[14] *See, e.g.*, David Kupelian, *Bernanke: Federal Reserve caused Great Depression*, WORLD NET DAILY (Mar. 19, 2008), http://www.wnd.com/2008/03/59405/.

[15] *Id*. at 7.

[16] PAUL KRUGMAN, FRIEDMAN AND SCHWARTS: MONETARY HISTORY OF THE UNITED STATES 352 (2007); *See generally*, PAUL KRUGMAN, WHO WAS MILTON FRIEDMAN (2008).

[17] *See generally* FRANK B. FREIDEL, FRANLINE D. ROOSEVELT: LAUNCHING THE NEW DEAL, ch. 19 (1st ed. 1973).

that could be backed by the gold in its possession. This credit was in the form of Federal Reserve demand notes.[18] A “promise of gold” is not as good as “gold in the hand”, particularly when they only had enough gold to cover 40% of the Federal Reserve Notes outstanding.[19] During the bank panics a portion of those demand notes were redeemed for Federal Reserve gold. Since the Federal Reserve had hit its limit on allowable credit, any reduction of gold in its vaults had to be accompanied by a greater reduction in credit. On April 5, 1933, President Roosevelt signed Executive Order 6201, making the private ownership of gold certificates, coins and bullion illegal, reducing the pressure on Federal Reserve gold.[20]

People normally believe that they could avoid further losses by keeping clear of the markets when the panic of recession and deflation set in. For example, people thought that holding money became profitable as prices dropped lower and a given amount of money bought ever more goods, exacerbating the drop in demand.

Monetarist economists’ views are giving us answers with specific facts. These are micro-economic answers to the questions regarding the main causes of the Great Depression. The broad version of the question is whether the Great Depression was caused by the failure of free markets or by a failure of government’s improper policy adoptions, such as failure of efforts to regulate interest rates, failure to curtail widespread bank failures, and failure to control the money supply. If people are in favor of a larger economic role for the state, it can be find the primary reasons

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[18] *Id.*

[19] *Id.*

[20] Exec. Order No. 6102 (1933), available at http://www.presidency.ucsb.edu/ws/?pid=14611.

from the failure of free markets. Also if people are in favor in smaller role for the state, they insist that it was primarily a failure of government that compounded the problem.

Keynesian economist also was in favor for one of those main diverting points. As the demand-driven theories mainly agreed, a large-scale loss of confidence led to a sudden reduction in consumption and investment spending. In general, the Keynesians agree that the collapse of the money supply lead to the Great Depression by decreasing aggregate demand and starting a downward spiral on prices (further decreasing aggregate demand). The Keynesian solution is to have the government under-take stimulus spending to increase aggregate demand.[21]

**2. Keynesian Theories**

The Keynesian economic theories addressed by John Maynard Keynes in the book, The General Theory of Employment, Interest and Money.[22] It was published in 1936, which was the middle of the Great Depression.[23]According to the Keynesian economists, the public sectors needed to act actively to respond to the private sector's decisions that sometimes lead to inefficient macroeconomic outcomes. In particular, fiscal policy actions by the government and monetary policy actions by the central bank need to respond to the public in order to stabilize aggregate demand for output over the business.[24]

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[21] *See generally* JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY, (Paul Krugman ed., Palgrave Macmillan 2007) (1936).

[22] *Id.*

[23] Alan S. Blinder, *Keynesian Economics*, *in* THE CONCISE ENCYCLOPEDIA OF ECONOMICS 316, 316-319, (David R. Henderson ed., 2008).

[24] ARTHUR O'SULLIVAN & STEVEN M. SHEFFRIN, ECONOMICS: PRINCIPLES IN ACTION, (2nd ed. 2003).

The Keynesian's solution to the problem was an aggressive government effort to revive demand, an infusion of cash and private sector confidence. Saving had always been considered a completely good thing, but under the economic recession what was needed was more spending. However, when consumers and businesses were too broke or too scared to spend, the private sector lost the power of consumption. The government would then have to be the spender of last resort. Budget deficits always become a concern whenever governments expand their spending. However, the Keynesian view on this concern is that when the private sector hunkered down and demand dried up, the public sector needed to send more money in the economy than it took back in taxes. Once consumers started spending again, businesses would hire more workers and make new investments, and the virtuous cycle of economic growth could begin again anew.[25]

### C. Government Response: the United States

#### 1. Under President Hoover

Initial government reactions to the crisis were minimal or even counterproductive. President Hoover argued that the nation's problems could be solved through "belt-tightening" and cutting government spending.[26] These measures of course just further decreased aggregate demand and made the recession worse.

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[25] LAWRENCE R. KLEIN, THE KEYNESIAN REVOLUTION 56–58, 169, 177–79 (1947); THEODORE ROSENOF, ECONOMICS IN THE LONG RUN: NEW DEAL THEORISTS AND THEIR LEGACIES, 1933–1993 ??? (1997).

[26] KENNETH G. DAU-SCHMIDT ET AL., LABOR LAW IN THE CONTEMPORARY WORKPLACE ??? (2009

However, the Hoover Administration had to change their thinking when the economic recession became more serious than they thought. Hoping to recover from the economic recession, President Hoover adopted several governmental programs, even though their all programs were failed to overcome in the early stages of the Great Depression. One of the programs was the Smoot-Hawley Tariff Act.[27] According to information from U.S. Department of State, the Smoot-Hawley Tariff Act of June 1930 increased U.S. tariffs to historically high levels.[28] The increasing strength of the protection that would be afforded domestic farmers against agricultural imports was the original intention behind the legislation.[29] During the 1920s, massive agricultural overproduction was made by the massive expansion in the agricultural production sector outside of Europe during World War I.[30] As a result of this massive production, the agricultural products' prices declined during the second half of the decade. Herbert Hoover pledged to help the beleaguered farmer by raising tariff levels on agricultural products in the 1928 election campaign.[31] However, once the tariff schedule revision process got started, it proved impossible to stop. Calls for increased protection flooded in from industrial sector special interest groups, and soon a bill meant to provide relief for farmers became a means to raise tariffs in all sectors of the economy. When the dust had settled, Congress had agreed to tariff levels that exceeded the already high rates established by the 1922 Fordney-McCumber Act and represented among the most protectionist tariffs in U.S. history.[32] Contrary to the U.S government's intent, the result of the Smoot-Howley Tariff

[27] 19 U.S.C. § 1654 (1930).

[28] *Id.*

[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *Id.*

Act was that other countries increased their tariffs against the United States which led to decreased international trade. As a result, it made the Depression worse. Thus, it became one of major failures of government response to the Great Depression.

The Hoover Administration also adopted the Emergency Relief and Construction Act that became a final attempt to recover from the recession under President Hoover.[33] The Emergency Relief and Construction Act mainly expanded government spending with public construction programs such as building dams. Along with the Act, the Reconstruction Finance Corporation (RFC) was created in 1932.[34] The purpose of the RFC was providing governmental money to sectors that suffered economic hardship. For instance, it included financial institutions, railroads, and farmers. Despite applying for several governmental programs, the Great Depression could not be overturned.[35] In the Keynesian view, the government spending policies made under President Hoover were not enough in terms of scale and amount for the national economy to recover from the Great Depression. More aggressive measures consistent with Keynesian economic theory were undertaken to end the Great Depression by the Roosevelt administration. The following chapter will discuss the different approach made by the Roosevelt Administration that adopt Keynesian's economic theories to play the stimulation policy.

### 2. President Roosevelt and the Rise of Keynesian Economic Theory

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[33] *See generally* T*EXT OF* E*MERGENCY* R*ELIEF AND* C*ONSTRUCTION* A*CT OF 1932—H. R. 9642*, 24 J. Am. Water Works Assoc. 1208, 1208-1230 (1932).

[34] *Id.* at 1208.

[35] *Id.*

Under the Roosevelt Administration, one of the most famous economic stimulation policies applied to recover from the recession was the New Deal. New Deal programs tried to stimulate demand, increase jobs, and provide relief for the impoverished. To achieve those goals, the U.S. government increased its spending and took decisive action, such as financial reforms of institutions, along with adopting Keynesian's economic theory.

During times of economic crisis, Keynesian economists called on governments to pick up the slack by increasing government spending and cutting taxes. Keynesian's basic idea was simple: to keep people fully employed, governments have to run deficits when the economy is slowing, as the private sector would not invest enough to keep production at the normal level and bring the economy out of recession. As the Depression wore on, Roosevelt tried public works, farm subsidies, and other devices to restart the US economy, but never completely gave up trying to balance the budget. According to the Keynesian theorists, this improved the economy, but the economy was not out of the recession until the start of World War II.[36]

The spending by the Roosevelt Administration was much increased from spending under the Hoover government, but the Keynesian theorists still criticized that the spending was not enough to bring out America from the recession. However, World War II was the turning point from the economic downturn, which is a common view among economists. [37] World War II became an external fact to accelerate government spending in keeping with Keynesian's claims

[36] *See also supra* p.1225

[37] *Id.*

that government should expand the spending to overcome the recession.[38] The United States' entry into the war in 1941 finally eliminated the last effects from the Great Depression and brought the U.S. unemployment rate down below 10%.[39] In the U.S., massive war spending doubled economic growth rates, either masking the effects of the Depression or essentially ending the Depression.[40] Thus, World War II made the government expand spending and aggregate demand. Along with this, another view is that conventional aggregate demand stimulus did not matter in the recovery from the Great Depression. Bernanke and Parkinson (1989) analyze the apparent trend reversion of employment in the 1930s and are struck by the strength of the recovery.[41] They argue, however, that the "New Deal is better characterized as having cleared the way for a natural recovery… rather than as being the engine of recovery itself."[42] They suggest that the trend reversion of the interwar economy is evidence of a strong self-corrective force.[43]

There is no consensus among economists regarding the motivating force for the U.S. economic expansion that continued through most of the Roosevelt years. The common view among many economists is that Roosevelt's New Deal policies either caused or accelerated the

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[38] *But see* WILLIAM E. LEUCHTENBURG, FRANKLIN D. ROOSEVELT AND THE NEW DEAL: 1932-1940 171, 245–6 (Harper Perennial 2009) (1963); HERBERT STEIN, PRESIDENTIAL ECONOMICS: THE MAKING OF ECONOMIC POLICY FROM ROOSEVELT TO REAGAN AND BEYOND (Simon & Schuster 1984) (New Dealers never accepted the Keynesian argument for government spending as a vehicle for recovery. Most economists of the era, along with Henry Morgenthau of the Treasury Department, rejected Keynesian solutions and favored balanced budgets.).

[39] *See generally The Great Depression and World War II (1929 - 1945)*, THE LIBRARY OF CONGRESS (Jan. 19, 2013), http://www.loc.gov/teachers/additionalresources/relatedresources/ushist/chrono/depressi.html.

[40] *Id.*

[41] Ben Bernanke & Martin Parkinson, *Unemployment, Inflation, and Wages in the American Depression: Are There Lessons for Europe?*, 79(2) AER P&P 210, 210-214 (1989).

[42] *Id.*

[43] *Id.*

recovery, although his policies were never aggressive enough to bring the economy completely out of recession.[44]

In particular, various initiatives were started by President Roosevelt under the "New Deal" in 1933 to create jobs and stimulate demand. The key initiatives were as follows. First was the creation of the Civilian Conservative Corps to provide work for men aged 18-35 using camps run by the War Department.[45] Second, the government created programs within the Agriculture and Interior Department for preservation of the nation's crops and forests.[46] Third, it created the Federal Emergency Relief Administration (FERA),which provided grants to states, and the Public Works Administration with a budget of $3.3 billion (approximately 6% of GDO) to provide funding to local governments for public projects. Another new agency, the Civil Works Administration (CWA) was created in 1934, which would bypass state officials and employ people directly.[47] The CWA workers were used to fix up city halls, docks, and public roads, all on the federal government's payroll. Finally, the Emergency Relief Appropriation Act gave the President about $5 billion for relief projects including highways, conservation, irrigation, electrification, housing, sanitation, reforestation, flood control and indeed any conceivable public good. Roosevelt used the act to set up the Works Progress Administration (WPA), which took over from FERA.[48]

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[44] *See generally* Gauti B. Eggertsson, *Great Expectations and the End of the Depression*, 98(4) AER 1476, 1476-1516 (2008); Gauti B. Eggertsson, *Was the New Deal Contractionary?*, FRBNY Staff Report No. 264 (2006); *See also* Gauti B. Eggertsson & Benjamin W. Pugsley, *The Mistake of 1937: A General Equilibrium Analysis*, CFS Working Paper No. 2007/06 (2006).

[45] Antonio Spilimbergo et al., *Fiscal Policy for the Crisis*, IMF Staff Position Note No. 2008/01, at 22 (2008).

[46] *Id.*

[47] *Id.* at 23.

[48] *Id.*

The WPA spent money directly from the national treasury, and hired workers to build hospitals, schools, playgrounds, and airports. The program drew criticism for spending public money to pay idle hands to do unproductive work.[49]

The tax revenues, however, kept pace with the rising expenditures during the 1930s. The Revenue Act of 1932 pushed up tax rates virtually across the board, but notably for the low and middle-income groups. Some of the changes brought about by the law. First, personal income tax exemptions were slashed and the normal tax, as well as surtax rates, was sharply raised. Second, earned-income credit equal to 25 percent of taxes on low incomes was repealed. Third, corporate tax rate was raised slightly, exemptions sharply reduced, and a gift tax was provided. Fourth, a broad new list of excise taxes was introduced and substantially higher rates were established for the old ones. Lastly, processing taxes were introduced later in the 30s, and social security taxes began in 1937.[50]

In addition, under the Roosevelt administration, there was one more contributing policy that stabilized the money supply and increased consumer confidence, and it was the Banking Act of 1935.[51] The Banking Act of 1935 effectively raised reserve requirements, restricted banking

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[49] *See generally* Eric Rauchway, THE GREAT DEPRESSION AND THE NEW DEAL: A VERY SHORT INTRODUCTION (Oxford University Press 2008); *See also* Paul Studenski & Kroose E. Herman, A FINANCIAL HISTORY OF THE UNITED STATES (McGraw-Hill 1952). It shows that the direct effects on aggregate full-employment demand of fiscal policy undertaken by all three levels of government was clearly relatively stronger in the thirties than in 1929 in only two years in which large payments were made under the veterans' adjusted compensation programs, which amounted to $1.0 billion in 1931 and $1.4 billion in 1936.

[50] *See generally supra* note 10.

[51] *See generally The 1930's: the Great Depression: 1929-1939*, FDIC, http://www.fdic.gov/about/history/timeline/1930s.html (last visited Dec. 15, 2012).

investments and provided for federal deposit insurance. These changes shored up the U.S. banking system preventing further bank failures and collapse of the money supply.[52]

### 2. The Great Recession of 2008

### A. History and General Definition

The recent global economic recession, the most severe since the Great Depression, is generally called the "Great Recession." However it is controversial whether it deserves the name of the Great Recession, capital 'G' and capital 'R', an obvious allusion to the Great Depression. Larry Summers, who was the President's economic adviser, thinks that it deserves the name 'Great Recession', and President Obama uses the words and the Associated Press has actually changed its stylebook and now uses the proper noun to describe the recession. Even though unemployment raised more in this recession than it did in any other previous recession since the Great Depression, there's still an argument among economists over whether to use the term 'Great Recession.''[53]

According to the National Bureau of Economic Research, Inc. NBER, the duration of the Great Recession was from end of 2007 to middle of 2009. The NBER does not define a recession in terms of two consecutive quarters of decline in real GDP. Rather, a recession is a significant

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[52] *See,* Steven Horwitz, *Unfortunately Unfamiliar with Robert Higgs and Others: A Rejoinder to Gauti Eggertsson on the 1930s,* 8 Econ Journal Watch 1, 1-12 (2011), http://econjwatch.org/articles/unfortunately-unfamiliar-with-robert-higgs-and-others-a-rejoinder-to-gauti-eggertsson-on-the-1930s.

[53] David Wessel, *Did Great Recession Live Up to the Name?*, WALL ST. J. (Apr. 8, 2010), http://online.wsj.com/news/articles/SB10001424052702303591204575169693166352882.

decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales.[54] Several factors caused the recession, such as bad financial situations and increasing price in oil and food. Among the several causes, the sub-prime mortgage and the global real estate bubble are the most significant trigger. On September 2008, with the failure of Leman Brothers, the U.S. reached the peak of its economic meltdown.

The Great Recession is significant not only in because of the depth and duration of the economic decline, but also because it affected all aspects of society. For example the Great Recession has affected the way government deals with the economy, the shape of finance, the new rules of the road for finance, and etc.

## B. Government Intervention

The Recession led to emergency interventions in many national financial systems. As the crisis developed into a genuine recession in many major economies, economic stimulus meant to revive economic growth became the most common policy tool. After having implemented rescue plans for the banking system, major developed and emerging countries announced plans to revive their economies using stimulus spending or tax cuts. In particular, economic stimulus plans were announced in Asia and the Americas.[55]

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[54] *US Business Cycle Expansions and Contractions*, NBER (Apr. 23, 2012), http://www.nber.org/cycles.html.
[55] *EU Proposes € 200 Billion Stimulus Plan*, Bloomberg Businessweek: Global Economics (Nov. 26, 2008), http://www.businessweek.com/stories/2008-11-26/eu-proposes-200-billion-stimulus-planbusinessweek-business-news-stock-market-and-financial-advice.

The U.S. government implemented several rescue policies designed to stimulate the economy consistent with Keynesian economic theory. For instance, the Obama administration that took over the government during the peak period of the recession applied the huge government spending policy such as ARRA and expanded the amount of the budget than was planned in the previous administration. Specifically, the Federal Reserve, Treasury, and Securities and Exchange Commission took several steps to intervene in the crisis. To stop the potential run on money market mutual funds, the Treasury also announced on September 19 a new $50 billion program to insure the investments, similar to the Federal Deposit Insurance Corporation (FDIC) program.[56] Part of the announcements included temporary exceptions to section 23A[57] and 23B[58] (Regulation W), allowing financial groups to more easily share funds within their group.

For instance, The Federal Reserve Board approved two interim final rules in connection with its initiative to provide liquidity to markets by extending loans to banking organizations to finance their purchases of high-quality asset-backed commercial paper (ABCP) from money market mutual funds. The first interim final rule would provide a temporary limited exception from the Board's leverage and risk-based capital rules for bank holding companies and state member banks. The second would provide a temporary limited exception from sections 23A and 23B of the Federal Reserve Act, which establish certain restrictions on and requirements for transactions between a bank and its affiliates.[59] The interim final rules approved by the Board were designed

[56] Diya Gullapalli & Shefali Anand, *Bailout of Money Funds Seems to Stanch Outflow*, WALL ST. J. (Sept. 20, 2008), http://online.wsj.com/news/articles/SB122186683086958875.

[57] 12 U.S.C. § 371c (1933).

[58] 12 U.S.C. § 371c-1 (1987).

[59] See *supra* note 57-58.

to facilitate participation by depository institutions and bank holding companies in this special lending program as intermediaries between the Federal Reserve and money market mutual funds.[60] The Securities and Exchange Commission announced termination of short-selling of 799 financial stocks, as well as action against naked short selling, as part of its reaction to the mortgage crisis.[61] In May 2013 as the stock market was hitting record highs and the housing and employment markets were improving slightly the prospect of the Federal Reserve beginning to decrease its economic stimulus activities began to enter the projections of investment analysts and affected global markets.[62]

The Recovery Act attempted to boost aggregate demand and jobs at a time when the American economy was hemorrhaging over 700,000 jobs a month.[63] The leading independent economic forecasters-firms like Macroeconomic Advisers, Moody's Economy.com, HIS Global Insights, J.P. Morgan Chase, and Goldman Sachs, as well as the Congress Budget Office-all agree that the stimulus helped stop the economic crisis and ending the peak point of the recession.[64] Of course, the Recovery Act was not the only government intervention that helped stabilize the

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[60] *Id.*

[61] *See* Vikas Bajaj & Graham Bowley, *S.E.C. Temporarily Blocks Short Sales of Financial Stocks*, N. Y. TIMES, (Sept. 19, 2008), http://www.nytimes.com/2008/09/20/business/20sec.html?pagewanted=all&_r=0.

[62] *See generally* Associated Press, *Housing and Jobs Data Suggest Steady Growth*, N. Y. TIMES, (May 23, 2013), http://www.nytimes.com/2013/05/24/business/economy/jobless-claims-decline-while-home-sales-rise.html.

[63] CBO'S ESTIMATES OF ARRA'S ECONOMIC IMPACT, CBO REP. No. 43014 (Feb. 2012).

[64] Alan S. Blinder & Mark Zandi, *How the Great Recession Was Brought to an End* (July 27, 2010), http://economy.com/mark-zandi/documents/End-of-Great-Recession.pdf;
*MA on Fiscal Stimulus, the Definitive Answer: It Works. MA Refutes the Demagoguery*, Macroadvisers: The Blog of Macroeconomic Advisers LLC (Feb. 19, 2010), http://macroadvisers.blogspot.com/2010/02/ma-on-fiscal-stimulus-definitive-answer.html;
*Fiscal Stimulus: A Little Less in Q2, A Little More Later*, GOLDMAN SACHS (Aug. 4, 2009);
Jackie Calmes & Michael Cooper, *New Consensus Sees Stimulus Package as Worthy Step*, N. Y. TIMES (Nov. 20, 2009).

economy. The Federal Reserve's emergency support for the financial sector, administrative rescue plan of the auto industry, and the even controversial Wall Street bailout that began under Bush administrative all helped keep it out from the recession.[65]

The Recovery Act was supported by Keynesian economic theories that urged policymakers to expand government spending during the economic downturns, to offset the decrease of private sector demand. When the Obama administration took over the government, the economic situation was literally a nightmare, such as credit was frozen, consumer confidence the lowest ever recorded, and the economy was shrinking at rate of 8.9 percent.[66] Under the nightmare, the Recovery Act lifted the economic situations with Keynesian theories: tax breaks for business and families to get cash circulating again; bailouts of employees; one-time handouts to seniors, veterans, and the disabled; generous expansions of unemployment benefits, food stamps, health insurance, and other assistance for struggling families.[67] The stimulus also put people to work directly with over 100,000 projects to upgrade roads, bridges, subways, water pipes, sewer plants, bus stations, fire stations, the Joseph R. Biden Jr. Railroad Station in Wilmington, Delaware, federal buildings, Grand Canyon National Park, trails, libraries, court houses, and much more. Many independent analysts insist the Recovery Act was saving or creating jobs upon its goal that was at least 3 million jobs in the short term. Although president Obama joked about the saving or creating at his annual Thanksgiving pardon that he just saved and created four turkeys, it is not deniable that the

[65] *Id.*
[66] Brent R. Moulton, *Result of the 2011 Flexible Annual Revision of the National Income and Product Account*, BEA (July 29, 2011); http://www.bea.gov/national/pdf/NIPAbriefing_AR2011.pdf.

[67] MICHAEL GRUNWALD, THE NEW NEW DEAL: THE HIDDEN STORY OF CHANGE IN THE OBAMA ERA 13 (2012).

Recovery Act saved at least 3 million people from unemployment.[68] Also, the CBO data showed that the Recovery Act increased output over 2 percent, the difference between growth and contraction.[69]

## III. Assessment of the ARRA 2009

### 1. General scope of the Acts

#### A. The general introduction of the ARRA

In response to the Great Recession, affected nations have created and set in motion various economic stimulus plans. Each government has the same basic tools, such as extending government spending and reducing taxes, in response to the recession. However, the result was varied for each country enacting said basic tools. The results, both intended and unintended, were affected significantly by 1) way of using available political tools, 2) the player's economic methodologies, and 3) the government's rationale for utilizing those economic tools.

The majority of economists state that the great recession began with economic decline in December 2007, with the most significant downturn occurring in September 2008. The global

[68] COUNCIL OF ECON. ADVISERS, *See* THE ECONOMIC IMPACT OF THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009: EIGHTH QUARTERLY REPORT, (Dec. 9, 2011); http://www.whitehouse.gov/sites/default/files/cea_8th_arra_report_final_draft.pdf (listing various estimates).

[69] ESTIMATED IMPACT OF THE AMERICAN RECOVERY AND REINVESTMENT ACT ON EMPLOYMENT AND ECONOMIC OUTPUT FROM OCTOBER 2012 THROUGH DECEMBER 2012, CBO REP. Pub. No. 4335 (Feb. 2012), http://www.cbo.gov/sites/default/files/cbofiles/attachments/02-22-ARRA.pdf (founding that the stimulus boosted quarterly economic growth by as much as 4.6 percent); COUNCIL OF ECON. ADVISERS, supra note 68. Private forecasters have estimated that the maximum effect was as little as 2.1 percent and as much as 3.8 percent.

economic downturn affected many nations but its triggers varied by nation and its effects were certainly not suffered equally. For the U.S., the sudden downturn of the U.S. subprime mortgage market was one of major triggers for the great recession. Further, the collapse of the subprime mortgage market was the epicenter of the financial crisis of 2007~2008. In response to the great recession, the U.S. government enacted American Recovery and Reinvestment Act of 2009 (ARRA) in the session of 111th United States Congress.[70]

Though President Obama is given credit for enacting the ARRA into law, the actual planning and drafting of the bills began prior to his inauguration on January 20th, 2009. The approximate cost of the bills was estimated to be $787 billion at the time of passage created, but it extended to $831 billion by the later revising by Obama's administration.[71] Obama administration released a report to support the expanding and to justify their methodologies for running of the economic stimulation plan on January 10th, 2009.[72] According to the report, "The job of The American Recovery and Reinvestment Plan", by Christina Romer, and Jared Bernstein, the saving and creating of at least three million jobs was one of main goals for the Obama administration.[73] The report supported not only the methodology that justify the extension of the ARRA, but also discuss how to make tax cuts, fiscal relief to the states, and increase the spending of infrastructures. In the end, the final version of the ARRA enacted by the 111th United State Congress in February 2009 and signed into law on February 17, 2009, by President Barack Obama.[74]

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[70] American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5 (2009).

[71] *See* CBO REP. Pub. No. 4335, *supra* note 69.

[72] CHRISTINA ROMER & JARED BERNSTEIN, THE JOB IMPACT OF THE AMERICAN RECOVERY AND REINVESTMENT PLAN (2009).

[73] *Id.*

[74] *See supra* note 70.

The goals of ARRA are expressly stated in Section 3 of the Act:

"1. To preserve and create jobs, and to promote economic recovery

2. To assist those most impacted by the recession

3. To provide investment needed to increase economic efficiency by spurring technological advances in science and health

4. To invest in transportation, environmental protection, and other infrastructure that will provide long-term economic benefits

5. To stabilize State and local government budgets, in order to minimize and avoid reductions in essential services and counterproductive state and local tax increases."[75]

The Act specifies that 37% of the package be devoted to tax incentives equaling $288 billion and 18% of funds, equaling $144 billion (need to correct), be allocated to state and local fiscal relief (with more than 90% of the $144 billion dedicated to states medical aid and education expenditures).[76] The remaining 45%, representing $357 billion, was allocated to federal spending programs such as transportation, communication, waste water and sewer infrastructure improvement, energy efficiency upgrades in private and federal building, extension of federal unemployment benefits, and scientific research programs.[77]

[75] *See supra* note 1.

[76] *See supra* note 71.

[77] *Id.*

**B. The Scale of the ARRA**

The ARRA's total $831 billion budget was enacted with a specified distribution.[78] First, the total tax incentives is $288 billion, of which $237 billion was dedicated to individual tax incentives[79] and the remaining $51 billion set-aside for non-individual tax incentives (such as business entities other than sole proprietors).[80] Second, the ARRA included the enactment of the Health Information Technology for economic and Clinical Health Act, also known as the HITECH Act (The Health Information Technology for Economic and Clinical Health Act) that included $155.1 billion for total health care spending.[81] Also, the Acts included $100 billion for education-based spending, as well as $82.2 billion for aid to low income workers, unemployed and retirees that was included under job training.[82] The total $105.3 billion infrastructure investment spending was distributed as follows: $48.1 billion for transportation; $18 billion for water, sewage, environment, and public lands; $7.2 billion for government building and facilitates; $10.5 billion for communications, information and security technologies; and $21.5 billion to energy infrastructure.[83] Moreover, $27.2 billion were allocated to energy efficiency and renewable energy

[78] Id.

[79] *Id.*

[80] *Id.*

[81] *See supra* note 71, div. A tit. 13.

[82] *See supra* note 71.

[83] *Id.*

research and investment and $14.7 billion to housing spending.[84] Lastly, $7.6 billion from the total spending was contributed to scientific research, and $10.6 billion to category of other items.[85]

### C. The Buy American Provision

To protect its own market, the ARRA introduced the "Buy American Provision."[86] This provision forcefully imposed a general requirement that any public building or public works project funded by the ARRA must utilize iron, steel and other manufactured goods produced in the U.S.[87] This clause caused several controversies, such as international trade conflicts as this clause by its nature is discriminatory and conflicted with free trade agreements already in effect.

### D. Recovery.gov as the transparency matter

The Obama administration defined clearly that the economic stimulus plan would provide unprecedented transparency for government acts from the early stages of the ARRA. The purpose of such transparency was to demonstrate to the American public how funds were spent by recipients of contracts, grants, and loans, as well as report the distribution of stimulus entitlements and tax benefits. The vehicle by which the Obama administration delivered and reported this

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[84] *Id.*
[85] *Id.*

[86] 49 U.S.C. § 5323(j) (1982).

[87] *Id.*

governmental transparency was released to the American public soon after; the Recovery.gov website debuted on February 17th 2009.[88]

In line with its transparency efforts, the US government also required the following controls and methods of evaluation:

"1. Federal agencies are required to report weekly on how they are distributing the funds,

2. Recipients of contract, grant, and loan awards Recovery funds (state/local governments, universities and other research institutions, non-profit organizations, private companies) are required to report every January, April, June, and October on how they are spending the funds and the number of jobs funded by Recovery,

3. All the information from both agencies and recipients is to be posted on Recovery.gov, which is managed by the Recovery Accountability and Transparency Board."[89]

In addition, the ARRA required the 'Recovery Board' that is called "The Recovery Accountability and Transparency Board". It is an agency of the United States federal government, which manages the Recovery.gov website and oversees spending under the American Recovery and Reinvestment Act of 2009. It is created to manage a websites to foster greater accountability and transparency in the use of funds made available in this Act.[90] The two major sources of all the

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[88] The Official U.S. Government website for the Recoery Accountability and Transparency Board, RECOVERY.GOV: From Boards to Screens to Cyberspace (2009), http://www.recovery.gov/Pages/default.aspx; "Recovery.gov is the U.S. government's official website that provides easy access to data related to Recovery Act spending and allows for the reporting of potential fraud, waste, and abuse."

[89] *Id.*

[90] *Id.*

data that provide on the site are Weekly Financial Reports by federal agencies and the reports submitted by the recipients themselves at FederalReposting.gov. The Board also manages both resources, and none of the data is changed, altered, or corrected by the Board prior to posting.

## 2. Legislative history

### A. Comparison of the Bill

The House version of the bill was introduced on January 26th 2009.[91] In the early state of the bill, there were 206-sheduled amendments for floor votes. However, they were combined into 11 amendments in later for quicker passage of the bill.[92] The senate version of the bill was introduced on January 6th, 2009, and it was changed later to the amendment of the House version. The significant changes between the House and the senate were the inclusion that was one-year extension of the bill's total. The following chart is the main difference of spending for each division between senate and the House.

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[91] *Bill Summary & Status 111th Congress (2009 – 2010)* H.R.1, The Library of Congress (Jan. 26, 2009), *U.S. Senate Roll Call Votes 111th Congress - 1st Session*, United States Senate (Feb. 9, 2009), http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=111&session=1&vote=00059.

[92] *Id.*

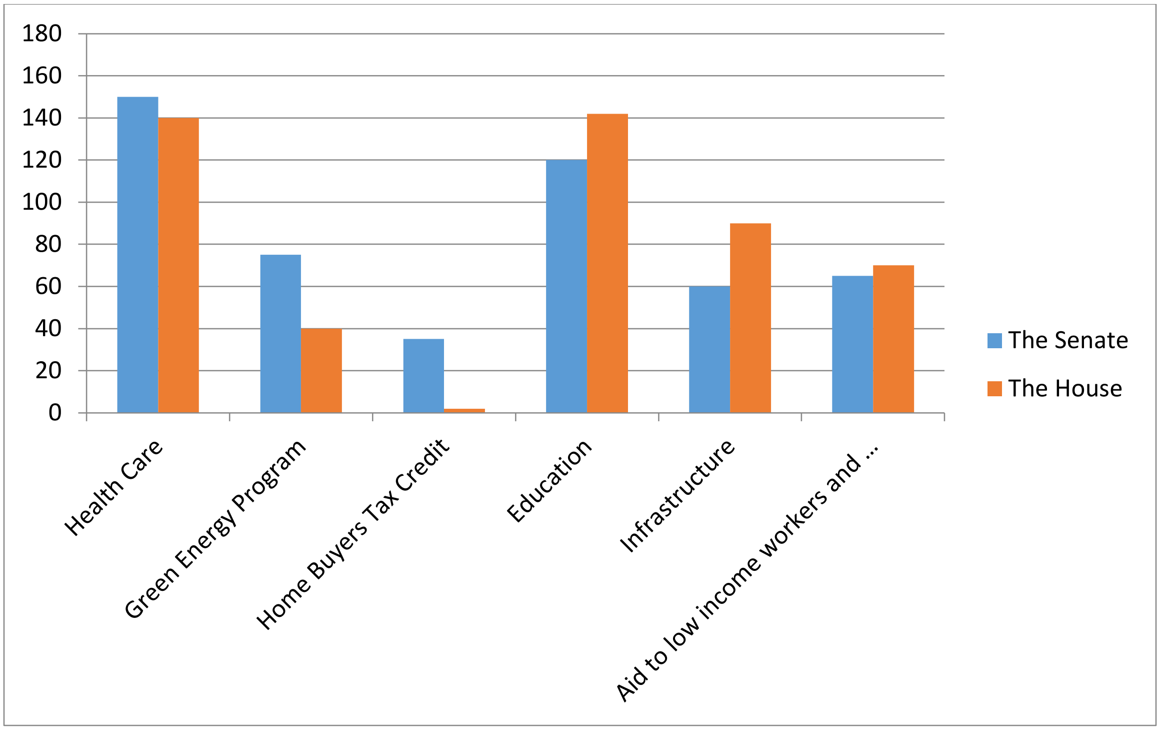


*Figure 3. The different amount of spending between the Senate and the House*[93]

### B. The different views of Republicans and Democrats

Republicans had a different view on the economic stimulus policies. Compared with the Democrats' view on the economic stimulation policies, Republicans were in favor of increasing the share of tax cuts, downsizing spending, and decreasing the overall size of the stimulus package.[94] The Democrats' view on the economic stimulus policies were supported by the rationales that were from Keynesian macroeconomic theory. Under this rationale the government should offset the decrease in private spending with an increase in public spending in order to maintain aggregate demand, save jobs and stop further economic deterioration.

[93] The House version of the bill, H.R. 1, and The senate version of the bill, S. 1.

[94] Bill Summary & Status, 111th Congress (2009~2010), S. ADMT. 106

To reduce the gap between both parties, president Obama and the Senate Democrats adopted some of Republicans' suggested amendments such as the increasing infrastructure spending and doubling the housing tax credit proposed from $7,500 to $15,000 and expanding its application to all home buyers, not just the first time home owner.[95] As a result, the Senate floor to vote in the bill itself. Finally, on February 10th, the Senate voted 61 vs. 37 that all democrats voted to pass the bill.[96]

### 3. The Competing Claims on the ARRA

As I mentioned briefly in the previous chapter, both the Democratic and Republican parties had a different view on the ARRA as well as the supporting economic theories for the bill. Understanding each parties' position on the ARRA is crucial to understanding the bill. Because it becomes a cornerstone to make a public policy and law making process, and it is not except of economic stimulation plans.

#### A. The Democrats' side

Democrats insisted that larger economic stimulation was needed to recover from the economic downturn. Also economists such as Joseph Stiglitz, the winner of Nobel Memorial Prize in Economic Science, and Larry Summers, National Economic Council director, agreed with the

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[95] Sheryl Gay Stolberg, *Obama Predicts Support from G.O.P for Stimulus Proposal at Intel*, N.Y. TIMES (Feb. 1, 2009), http://www.nytimes.com/2009/02/02/us/politics/02obama.html?ref=economy&_r=0.

[96] *U.S. Senate Roll Call Votes 111th Congress - 1st Session*, United States Senate (Feb. 9, 2009), http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=111&session=1&vote=00059.

need for substantial economic stimulus. Moreover, Martin Feldstein, the George F. Baker Professor of Economics at Harvard University, and the president emeritus of the National Bureau of Economic Research (NBER), addressed his concern over the ARRA that the Act needed revision to address consumer spending and unemployment more directly.[97] Also, Paul Krugman, Professor of Economics and International Affairs at Princeton University, Centnary Professor at the London School of Economics, and winner of Nobel Memorial Prize in Economic Sciences, insist that even the Democrats' view on the stimulus was too small to effectively combat the recession. In the N.Y Times article, he addressed that it's widely believed that political considerations led to a plan that was weaker and contains more tax cuts than it should have that Mr. Obama compromised in advance in the hope of gaining broad bipartisan support.[98]

### B. The Republicans' side

Some of Republican was alarmed the election of Barack Obama and a largely Democratic Congress from the very first stage of their governing. Because they expected that the Obama administration would be oriented toward bigger government that is significantly favored variety of programs with the increasing size of government.

To contradict President Obama's January 9th announcement, which is "There is no disagreement that we need action by our government, a recovery plan that will help to jumpstart the economy." 200 economists expressly addressed their opposing view for the Obama administration's policy on January 28, 2009. They publicized full-page advertisement in New

[97] Jay Fitzgerald, *Harvard Prof Slams Stimulus Plan at Intel*, BOS. HERALD (Jan. 30, 2009), http://bostonherald.com/business/business_markets/2009/01/harvard_prof_slams_stimulus_plan.

[98] Paul Krugman, *Failure to Rise at Intel,* N.Y. TIMES, February 13, 2009, at A31.

York Times and Wall Street Journal: Notwithstanding reports that all economists are now Keynesians and we all support a big increase in the burden of government, we the undersigned do not believe that more government spending is a way to improve economic performance. More government spending by Hoover and Roosevelt did not pull the United State economy out of the Great Depression in the 1930s. More government spending did not solve Japan's "Lost Decades" in the 1990s. As such, it is U.S. Today. To improve the economy, policymakers should focus on reforms that remove pediments to work, saving investment and production. Lower tax rates and a reduction in the burden of government are the best ways of using fiscal policy to boost growth. In short, those 200 economists insisted that larger stimulation will be the burden to government, so the best way to apply stimulus plans are reduction of tax rates, and to focus on reforms that remove impediments to work, saving and decreasing the overall price. Thus, they are in the same line with Republican's opinion that is consisted with increasing the share of tax cuts, downsizing spending, and decreasing the overall price.

### C. Other Opinions

As I mentioned previously, some of economists argued the stimulation plan is not big enough to recover the current recession. First, in July 18, 2010, sixteen notable economists and historians have joined in a consensus statement for The Daily Beast demanding urgent action on unemployment and the faltering recovery.[99]

[99] *Reboot America*, THE DAILY BEAST. (Jul. 18, 2010), http://www.thedailybeast.com/articles/2010/07/19/save-the-economy-a-manifesto-by-harry-evans-joseph-stiglitz-alan-blinder-and-other-leaders.html.

They addressed their recognition of the necessity of a program to cut the mid-and long-term federal deficit. They also point out the historical lessons from the 1930s that the economy was suffered a harsh decline in aggregate demand and loss of business confidence. Thus, they insist that monetary policy may not enough, particularly in deep slumps, as Keynes noted. The urgent need is for government to replace the lost purchasing power of the unemployed and their families and to employ other tax-cut and spending programs to boost demand. Making deficit reduction the first target, without addressing the chronic underlying deficiency of demand. Is exactly the error of the 1930s. it will prolong the great recession, harm the social cohesion of the country, and continue inflicting unnecessary hardship on millions of Americans.

In addition, with twenty-four more economists joining, including two Nobel Prize winners, a group of 40 prominent economists criticized the stimulation plan in a statement in July 2010.[100]

Everett Ehrlich, former Undersecretary of Commerce and Chief Economist of Unisys Corporation, who is one of those 40, mentioned that economic policy under the Obama Administration has succeeded in averting the most stunning economic implosion since the Great Depression. And it almost succeeded in setting a sustained recovery in motion. But just at the point when self-sustaining growth was about to take hold, the world was buffeted by a new crisis in the Eurozone, which confronted the economy with new uncertainty and stifled growth. Economists are right to worry about the growth in federal debt. Hopefully, their rectitude will persist into 2012 and 2013, when deficit reduction will be of growing importance. But, for the moment, the economy's primary need is additional stimulations, not fiscal contraction. The examples of over-stimulus during economic crises are few if any. Moreover, the primary danger of over-stimulation,

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[100] *Economists say stimulus won't work,* ST. LOUIS POST-DISPATCH. (Jan. 29, 2009), http://stltoday.com/blogzone/mound-city-money/us-economy/2009/01/economists-syas-stimulaus-wont-work.

inflation, is far from a realistic concern- the real threat is deflation, which favors deferring demand and investment. And if the overhang of federal debt were an active (as opposed to prospective) concern, the interest rate on 10 years government bonds would be substantially in excess of the current and partly 2.6 percent. The economy is primed for growth. Banks hold over a trillion in non-borrowed reserve. Corporations have accumulated $1.8 trillion in cash. But a spark is needed to turn this kindling into a fire. Only government can do this –stimulation will never be more appropriate nor prospectively productive than it is now. We should extend employer Social Security tax reduction, provide more aid to the states and localities, commit to a long-term program of public infrastructure investment, and use the Fed's balance sheet to buy small business loans from banks if they will absorb the first 10~ 15 percent of possible loss.

## 4. The estimated impact of the ARRA

### A. The first forecast report by the Congressional Budget Office

The Congressional Budget Office (CBO) foresaw the outcomes of the stimulus plan that would increase GDP relative to the agency's baseline forecast by between 1.2 percent and 3.6 percent by the end of 2010.[101] The CBO also estimated the increasing of employment by 1.3 million to 3.9 million jobs by the end of 2010.[102] In the end of 2010, the unemployment rate would be 0.7 percentage point to 2.1 percentage points lower than the baseline forecast of 8.7 percent. The effects of the legislation would diminish rapidly after 2010.[103] By the end of 2011, the

[101] RA & TB, *Supra* note 89.

[102] *Id.*

[103] *Id*.

stimulation plan foresaw that it would increase GDP by 0.4 percent to 1.2 percent, would raise employment by 0.6 million to 1.9 million jobs, and would lower the unemployment rate by 0.3 percentage points to 1.0 percentage point.[104]

The CBO also analyzed the relationship between output and employment. It derived its estimate of the Act on employment from the estimated effect on GDP. The CBO also adopted the historical evidence that 1 percentage point faster over a year GDP growth (”relative to a baseline forecast”) would cause the unemployment rate to decline by a little more than half a percentage point (“relative to a corresponding baseline forecast”). Moreover, the CBO argued that the fall in the unemployment rate leads more people to enter the labor force and seek jobs and fewer to drop out. Therefore, employment rises both from a decline in the number of unemployed workers and a decline in the number of people of the labor force. In addition, some workers otherwise working part time move to full-time status.[105]

Thus, the CBO estimated the result from the stimulation plan would increase economic outputs and employment in the short run. In addition, including the effects of both crowding out of private investment (“which would reduce output in the long run”) and possibly productive government investment (”which could increase output”), the CBO estimates that by 2019 the Act would reduce GDP by 0.1 percent to 0.3 percent on net.[106] In the long run, the ARRA would reduce the output slightly by increasing the government’s debts and decreasing supply of private

[104] *Id.*

[105] *Id.*

[106] *Id.*

investment. However, it would be offset by other factors, such as increased spending for basic research and education, and improvements to roads and highways.[107]

## B. Direct and Indirect Impacts

The CBO used various economic models and historical data to guide its estimate of the way in which output and employment are affected by increases in outlays and reductions in revenues under ARRA. The CBO's assessment is that different elements of ARRA have had different effects on economic output per dollar of higher spending or lower tax receipts. Multiplying estimates of those per-dollar effects by the dollar amount of each element of ARRA yields an estimate of the law's total impact on output.

The CBO used evidence from models and historical relationships to determine direct and indirect effects in ARRA. Direct effect consists of immediate effects on economic activity. Government purchases of goods and services directly add to the nation's output, dollar for dollar. For reductions in taxes, increases in transfer payments, and increases in aid to state and local governments, the size of the direct effect depends on the policy's direct impact on the behavior of recipients.

[107] *Id.*

The CBO reviewed evidence on the responses of households, businesses, and governments to various types of tax cuts and transfer payments to estimate the size of those policies' direct effects on output.[108]

Government policies also can have indirect effects that enhance or offset the direct effects. Direct effects are enhanced when, for example, a government policy creates jobs and those who are hired use their income to boost consumption. Direct effects also are enhanced when greater demand for goods and services prompts companies to increase investment to bolster their future production.

### C. The ARRA's long-term effects and concern about the debt

In contrast to its positive macroeconomic effects, ARRA will reduce output slightly in the long run, CBO estimates- by between 0 and 0.2 percent after 2016. But CBO expects that the legislation will have no long-term effects on employment because the U.S. economy will have a high rate of use its labor resources in the long run.[109]

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[108] On household spending, for example, *see* Jonathan A. Parker and others, "Consumer Spending and the Economic Stimulus Payments of 2008" (September 2010), www.kellogg.northwestern.edu/faculty/parker/htm/research/PSJM2010.pdf; Matthew D. Shapiro and Joel Slemrod, "Did the 2008 Tax Rebates Stimulate Spending?" *American Economic Review*, vol. 99, no. 2 (May 2009), pp. 374–379; Sumit Agarwal, Chunlin Liu, and Nicholas S. Souleles, "The Reaction of Consumer Spending and Debt to Tax Rebates: Evidence from Consumer Credit Data," *Journal of Political Economy*, vol. 115, no. 6 (December 2007), pp. 986–1019; and David S. Johnson, Jonathan A. Parker, and Nicholas S. Souleles, "Household Expenditure and the Income Tax Rebates of 2001," *American Economic Review*, vol. 96, no. 5 (December 2006), pp. 1589–1610.

[109] The reduction if GDP is therefore estimated to be reflected in lower wages rather than less employment, as workers will be slightly less productive because the capital stock will be slightly smaller. *See generally*, CONGRESSIONAL BUDGET OFFICE, letter to the Honorable Judd Gregg concerning the estimated macroeconomic impacts of H.R. 1 as passed by the House and the Senate (February 11, 2009).

ARRA's long-run impact on the economy stems primarily from the resulting increase in government debt. To the extent that people hold their wealth in government securities rather than in a form that can be used to finance private investment, the increased debt tends to reduce the stock of productive private capital. In the long run, each dollar of additional debts crowns out about a third of a dollar's worth of private domestic capital, CBO estimates. (The remainder of the rise in debt is offset by increases in private saving and inflows of foreign capital.) Because of uncertainty about the degree of crowding out, however, CBO's range of estimates of ARRA's long run effects reflects the possibility that the extent of crowding out could be more or less than one-third of the added debt.

Over the long term, the output of the economy depends on the stock of productive capital, the supply of labor, and productivity. The less productive capital there is as a result of lower private investment, the smaller will be the nation's output over the long run. The effect of the crowding out of some private investment under ARRA will be offset somewhat by other factors. Some of ARRA's provisions, including its funding for roads and highways, may add to the economy's potential output in much the same way that private capital investment does. Others, including its funding of education, may raise long-term productivity by enhancing people's skills. Still other provisions create incentives for increased private investment.

### D. The advantage and disadvantage of CBO's model-based approach

A key advantage of the model-based approach used in this analysis is the ability to provide estimates of the total effects throughout the economy of the government spending, transfer payments, and tax cuts resulting from ARRA. By focusing on the net change in employment, that approach captures both the jobs created and the jobs retained as a result of ARRA.

Another key disadvantage of the model-based approach is the considerable uncertainty about many of the economic relationships that are important in the modeling. Because economists differ on which analytical approaches provide the most convincing evidence about such relationships, they can reach different conclusions about those relation- ships. In addition, each study involves uncertainty about the extent to which the results reflect the true effects of a given policy or the effects of other factors. For those reasons, CBO provides ranges of estimates of ARRA's economic effects that are intended to encompass most economists' views and thereby reflect the uncertainty involved in such estimates.

**E. Results**

CBO estimates that ARRA's policies had the following effects in the fourth quarter of calendar year 2011: first, they raised real gross domestic product by between 0.2 percent and 1.5 percent, second, they lowered the unemployment rate by between 0.2 percentage point and 1.1 percentage points, third, they increased the number of people employed by between 0.3 million and 2.0 million, and fourth, they increased the number of full-time –equivalent jobs by 0.4 million to 2.6 million.[110]

[110] RA & TB, *Supra* note 71.

The effects of ARRA on output peaked in the first half of 2010 and have since diminished. The effects of ARRA on employment are estimated to lag slightly behind the effects on output. The employment effects began to wane at the end of 2010 and continued to do so throughout 2011. ARRA raised real GDP in 2012 by between 0.1 percent and 0.8 percent and will increase the number of people employed in 2012 by between 0.2 million and 1.1 million. Also, CBO estimate that short-term interest rates will stay close to zero through 2013 and raise only slightly in 2014.[111] In addition, 213,094 full-time-equivalent jobs were funded by ARRA during the fourth quarter in 2011.[112]

## IV. The Predictable Problem and Learning from Korea

### 1. The Predictable Problem: Budget deficits

Generally, economic downturns tend to increase the national debt that is from both a reduction in revenues and an increase in social spending. Moreover, during the Great Recession America spent a huge amount of money to recover from this economic meltdown, including the ARRA. The current U.S. national debt is $17.5 Trillion in Gross Government Debt and $12.5

[111] *See generally*, CONGRESSIONAL BUDGET OFFICE, ESTIMATED IMPACT OF THE AMERICAN RECOVERY AND REINVESTMENT ACT ON EMPLOYMENT AND ECONOMIC OUTPUT (Nov. 2012).

[112] *See generally*, Working Paper, Top Agencies, as Reported by Recipients, The Official U.S. Government Website for the Recovery Accountability and Transparency Board (Oct.1- Dec. 31, 2010), www.recovery.gov/Pages/TextView.aspx?data=jobSummary-Agency&topnumber=200&qtr=2011Q4.

trillion in Net Government Debt which excludes intergovernmental debt such as debt owed to the Social Security Trust Fund. At the end of 2013, gross government debt was 101% of GDP while debt held by the public represented about 72% of GDP.[113]


*History of the U.S.A public debt, source by Congressional Budget Office*[114]

Thus, the question is at what point are debt levels high enough to cause investors to demand significantly higher interest rates and a fiscal crises ensues? Countries with high debt relative to GDP cannot be complacent, even if they currently face low sovereign interest rates. Such countries are always vulnerable to an adverse feedback loop in which high debt loads, culminating in a tipping point[115] in which the interest rate shoots up.[116] According to the Gladwell, based on an analysis of 20 countries, he insists 80% of GDP is the serious point as long as the country is running

[113] Congressional Budget Office, HISTORICAL DATA ON FEDERAL DEBT HELD BY THE PUBLIC (Jul. 2010), http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/117xx/doc11766/2010_08_05_federaldebt.pdf.

[114] *Id.* US debt as a percentage of GDP.

[115] The tipping point is first debuted in the book, How Little Things Can Make a Big Difference, by Malcome Gladwell in 2000. Gladwell defined as tipping point as "the moment of critical mass, the threshold, the boiling point."

[116] *See generally*, GLADWELL, MALCOLM, THE TIPPING POINT: HOW LITTLE THINGS CAN MAKE A BIG DIFFERENCE (2000).

a persistent deficit.[117] Also, some Economisst think that debt above 90% of GDP lead to a decline in economic growth.[118] When we applied to the US and using CBO projections, the US will hit this 80% in 2024.[119] However, this is based only on publicly held debt and the gross debt-to-GDP is already over this threshold point. Thus, the expansion of spending, such as ARRA, should not be the only solution to recover current economic recession.

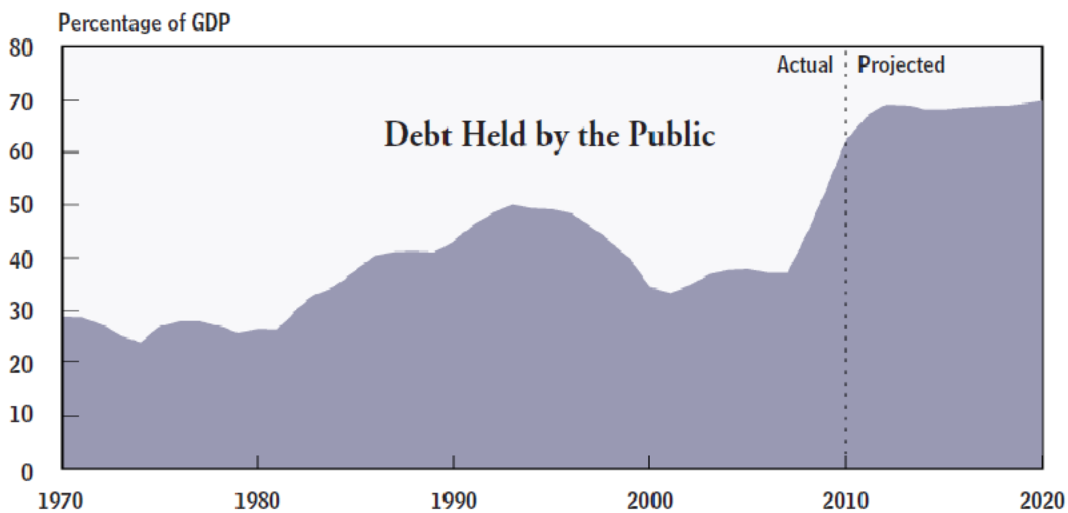


*Figure 4. Federal Debt Held by the Public (percentage of gross domestic product)*[120]

## 2. Korea Economic Crisis in 1997 and Government's Approach for the Crisis

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[117] *Id*.

[118] *See generally*, Carmen M. Reinhart & Kennth S. Rogoff, *Growth in a Time of Debt*, CTR. ON NATIONAL BUREAU OF ECONOMIC RESEARCH 15639 (Jan. 2010), http://www.nber.org/papers/w15639.

[119] CONGRESSIONAL BUDGET OFFICE, THE 2013 LONG-TERM BUDGET OUTLOOK, http://www.cbo.gov/publication/44521

[120] CONGRESSIONAL BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK (Aug. 2010), http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/119xx/doc11999/12-14-federaldebt.pdf.

In late 1997, Korean banks could not roll over short-term loans, despite the announced government guarantees for foreign debt. In addition, the Japanese banks, which were suffering from their growing non-performing loans, withdrew a large percentage of their loans.[121] The inability to roll over foreign loans triggered runs on the currency and the Korean won depreciated 25% in late November from its pre-crisis level. Currency market intervention left Korea with less than $6 billion USD in usable foreign exchange reserves in December.

By early 1998, most commercial banks and other financial institutions in Korea were technically in default due to the severe depreciation and high interest rates. The twin crisis (BOP and the financial sector) together with tight monetary policy led to a severe recession with real GDP shrinking by 8.4 percent in the third quarter of 1998 compared with the same quarter in the previous year.

[121] Foreign loans to Korea by Japanese financial institutions dropped from USD22 billion at the end of 1996 to USD9 billion by the end of 1997.

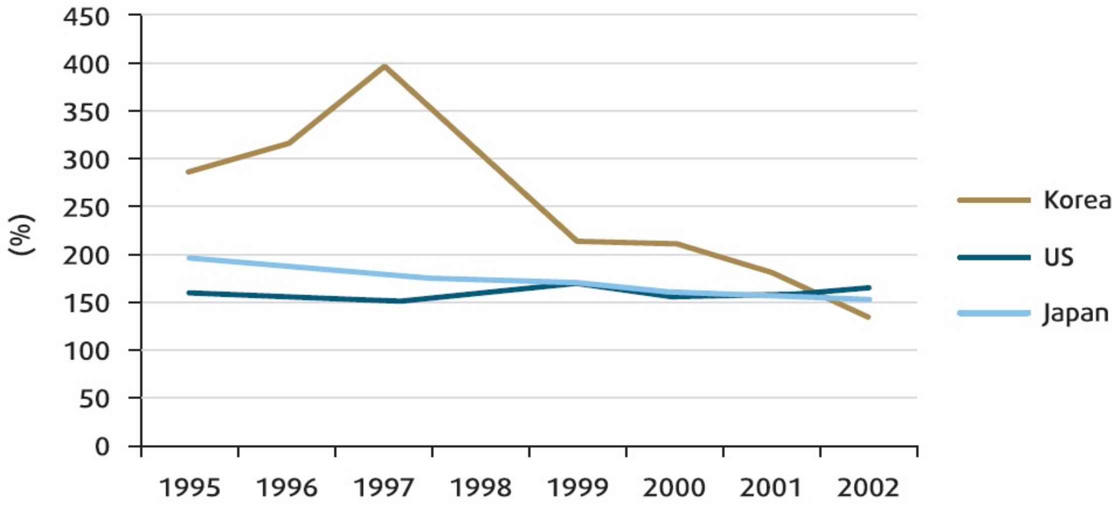


*Figure 5. Debt-to-equity ratio for the manufacturing sector in Korea, Japan, and the US, 1995-2002*[122]

The recovery had depended on more concerted policy actions not only to stabilize financial conditions but also to sustain strong growth. One of the key policy actions is resolving the crisis, and this calls for tackling faced problem in the financial and corporate sectors. Thus, government must quickly resolve balance sheet uncertainty by dealing aggressively with distressed asserts and recapitalizing viable institutions.

For that reason, the Korean government's stimulation plan was focused on improving the balance sheets of the financial and corporate sectors. Two major commercial banks were nationalized, and the government initiated the exit process of non-viable financial institutions through mergers, debt-equity swaps, and liquidations. In 1998, 5 of 33 banks were closed, and 3 banks were merged.[123] During this process, the Korea Asset Management Corporation (KAMCO)

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[122] Aleksandra Iwulska, *Golden Growth: Restructuring Private Debt, Republic of Korea*, BRYCE QUILLIN FOR THE WORLD BANK REPORT, (2011), http://siteresources.worldbank.org/ECAEXT/Resources/258598-1284061150155/7383639-1323888814015/8319788-1324485944855/01_korea.pdf. "The debt-to equity ratio equals the total liabilities to shareholder's equity. In the case of Japan, time series data for shareholder's equity start from 2007. As a result, net assets were used instead, following the methodology of Iwaisako et al."

[123] Overall, about 15% of financial institutions operating in 1997 were closed down in 1998.

played a central role in loan consolidation. At the same time, the government supported the remaining financial institutions through full deposit guarantees, recapitalization, and the purchase of bad loans.

Delay in implementing comprehensive policies to stabilize financial conditions would have resulted in a further intensification of the negative feedback loops between the real economy and the financial system, leading to an even deeper and prolonged recession. However, KAMCO undertook quick and strong actions to implimnet the stimulation plan in Korea. These measures helped to quickly stabilize the financial sector. Furthermore, the centralized support packages enabled the government to control most of the financial institutions' decision-making process. Through its administrative power, the Financial Supervisory Commission pressured the commercial banks to roll over most of existing debt of small and medium enterprises until the end of 1998.

At the same time, the banks, over which the government had control, led voluntary corporate debt workouts for large conglomerates. Various financial restructuring methods were used, including debt/equity swaps, asset sales, inducement of foreign investment, and new equity injection. Eight major creditor banks, identified as leading banks, took the responsibility for negotiating workouts with the 64 major corporate groups. In Korea, debt/equity swaps have proved to be a very effective method to restructure highly leveraged corporations and creditor banks.

The restoration of financial sector stability and market trust is a necessary condition for reversing the downward momentum of the economy, enhancing the effectiveness of macroeconomic policies, and paving the way for an enduring recovery. Thus, in order to facilitate the restructuring process of the financial and the corporate sectors, the Korean government made some legislative changes, including the liberalization of hostile corporate takeovers by foreigners.

In order to facilitate the restructuring process of the corporate sector, some legislative changes were made, including the liberalization of hostile takeovers by foreigners. The Korean government removed the limit to foreign ownership, and created provision for tax incentives. It also acted to improve labor market flexibility. Fiscal support to the economy mostly focused on the financial sector. Most of the financial (and institutional) resources that the government could mobilize were spent on stabilizing the financial sector and the balance sheet of the corporate sector. These efforts were followed by a fast recovery of the economy in 1999–2000 (real growth at 9.5% and 8.5%, respectively).[124]

The distinguishable facts on the Korean stimulus program are as follows. The Korean government supported full-scale evaluations of all financial institutions to assess the balance sheets. Based on this assessment, the government quickly decided which institutions would survive. The Korean government response was fast and aggressive (the package in support of financial institution amounted to 13 percent of GDP in 1998–99)[125], and its support was strongly conditioned on management reform. While the country had problems in the corporate sector balance sheet, Korea's ability to contain its downward spiral had a lot to do with the government's role as a moderator in the financial market and its ability to facilitate corporate sector restructuring through creditor banks than other government in the similar situation. The Korean government did not wait for market forces to stabilize the financial sector. Instead, it aggressively controlled the financial institutions to keep the country's credit system intact and to push corporate sector restructuring.

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[124] Juhun Kim, Financial Crisis and the Small and Medium Enterprise in Korea, 9809, KOREA DEVELOPMENT INSTITUTE, (2010), http://www.kdi.re.kr/report/report_class_etc.jsp?pub_no=968.

[125] *Id.*

It is argued that the Korean financial crisis resulted from the backward financial industry and the aggressive and imprudent behavior of Conglomerate based industrial system under the control of the government. Thus some Korean economists suggested that the way to restore economic vitality is to activate the function of the market mechanism. It means that the Korean economy required an overall restructuring toward a market economy. However, in the meanwhile, they insisted that the costs of restructuring were not shared among firms evenly under the current economic system. Indeed, there should share the restructuring cost of labor workers and the Small and Medium Enterprises (SMEs) be greater than those of financial companies and large firms.

## V. Conclusion

The ARRA of the United States contains elements of a good strategy, but more specifics will be needed to calm frayed market sentiment. The plan is broad in scope and include a capital injection program for banks, the expansion of the Federal reserve's Term Asset-backed Securities Loan Facility (TALF) program[126], and a program to limit preventable foreclosures by encouraging loan modifications. However, essential details are still lacking, which has limited its impact on market conditions. Critical details concerning the valuation of distressed assets remain unclear. The plan also does not address how severely undercapitalized or insolvent banks will be resolved, or clarify the role of the vehicle that will hold the government's preferred shares. Greater clarity on all these issues will be critical to ensure the plan's effectiveness and to alleviate financial market

[126] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REGULATORY REFORM: TERM ASSET-BACKED SECURITIES LOAN FACILITY (last visited Oct. 11, 2013), http://www.federalreserve.gov/newsevents/reform_talf.htm

strains. The house sector needs further support. The Homeowner Affordability and Stability Plan is a step in the right direction. However, the plan focuses largely on improving affordability through lower interest payments, with little emphasis on addressing negative equity.

In addition, generally, emerging economies should prepare, on a contingent basis, plans to address the growing risks of large-scale corporate failures. Comprehensive mechanisms are needed to reduce the risk of systemic solvency problems, along with a strengthening of corporate workout frameworks. However, the ARRA has limited access to deal with possible bank runs, including whether existing mechanisms are sufficient or if they need to be bolstered. Also, the ARRA lacks a legal frameworks for corporate insolvencies may need to be put in place or modified to promote efficient and predictable resolution of mounting debt problems in the corporate sector.

Economic stimulation policy should be timely, large, diversified, collective (global), sustainable (to avoid dent explosion in the long run and adverse effects in the short run). A common approach to deal with economic recession usually consists of two main sets of policy measures. One is to repair the financial system, the other is to increase demand and restore confidence.

To be a successful and sustainable resolution, the policy should begin with resolution of the financial sector. The archetypal example here is Japan, where fiscal actions following the bursting if its asset bubble failed to achieve sustained recovery because financial sector problems were allowed to fester. Delaying interventions, as was also done in the U.S. during the Hoover administration and during the Savings and Loans crisis, typically leads to a worsening of macroeconomic conditions, resulting in higher fiscal costs later on. Prompt and sizeable support to the financial sector by the Korean authorities limited the duration of the macroeconomic consequences thus limiting the need for the other fiscal action.

In theory, public spending on goods and service has larger multiplier effects and, most important in the current circumstances, its first round effects are more certain than those related to transfers or tax cuts. In practice, the appropriate increase in public spending is constrained by the need to avoid waste. The following is the key policy prescriptions.

First, and quite simply, governments should make sure that existing programs are not cut for lack of resources. In particular, central governments or sub-national governments that are facing balanced budget rules may be forced to suspend various spending programs. For sub-national entities, this can be mitigated through transfers from the central government. Suspending the rules for sub-national governments would not be appropriate as it will be difficult to reverse the suspension later. In the U.S. increased transfers from the federal government would help states avoid cutting various spending programs.

Second, public sector wage increases should be avoided as they are not well targeted, difficult to reverse, and similar to transfers in their effectiveness. Nevertheless, a temporary increase in public sector employment associated with some of new programs and policies may be needed.

Third, in terms of tax spending matter, it should include the greater provision of unemployment benefits, increases in earned income tax credits. Where relevant, support for homeowners facing foreclosures, including a write-down of mortgages using public resources is particularly appealing from a macroeconomic viewpoint as it helps not only support aggregate demand, but also improve conditions in the financial sector.

Fourth, the government should express clearly policy with a strong commitment by policy makers to take whatever action may be needed to avoid the tail risk of a depression, are likely to reduce uncertainty, lead consumers to decrease precautionary saving, as well as stop waiting and start spending again.

Fifth, to reform firms that are facing economic distress, the government should provide guarantees on new credit, because private financing is not available to those firms in the recession. However, it has been argued that governments should provide support to entire high-visibility sectors of the economy because of the potential effect that bankruptcies in these sectors may have on expectations and thus on demand.

Sixth, the current stimulus plan was designed for long-term fiscal framework, but most spending was in the early stage of the plan. In addition to it, the government needs to provide more robust medium-term fiscal frameworks, as well. These should cover a period of 4-5 years and ideally include: accurate and timely projections of government revenues and expenditures; a government balance sheet reporting data on government assets and liabilities; a statement of contingent liabilities and other fiscal risks; and transparent arrangements for monitoring and reporting fiscal information for central and sub-national government, other public sector entities, and central bank quasi-fiscal operations, on a regular and timely basis. Such frameworks should be designed to give confidence that increase in public debt resulting from the stimulus are eventually offset.

In the last, government should not forget that the main threat to the long-term viability of public finances in rapidly-aging countries comes from the growth in the net cost of publicly funded pension and health entitlements, whose net present values far exceed the magnitude of conceivable fiscal stimulus packages.

During a recession, government is in a better position than private investors to buy and hold distressed private assets, it may want to do so, in effect, partly the private sector in financial intermediation. For instance, the government could issue treasury bills and use funds to provide financing for some of the ultimate borrows. The public sector does not have a comparative advantage in evaluating credit risk, nor in administering a diverse portfolio of assets. A possible solution may be to outsource the management of the banking activities to a private entity.

The government also could provide insurance against extreme recessions by offering contracts, with payment. Bank could condition loan approvals on firms having purchased such insurance from the government. This is analogous to the flood insurance that mortgage companies often require from borrowers. While such contracts would most likely be attractive to firms, which suffer disproportionately during large recessions, they could be open to individuals as well.

Temporary reduction in consumption tax rates has more disadvantages than advantages. It might raise the purchasing power of households and encourages current consumption by lowering its price with respect to future consumption. However, it may not be enough to encourage spending in an uncertain environment with a crisis in confidence.

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