

# The Impact of the ARRA Stimulus Package on the Construction Industry

## Overview

The Economic Stimulus package, officially known as the American Recovery and Reinvestment Act of 2009 (ARRA) has now been signed into law by President Obama. The best estimate of the overall direct cost of the package is \$789 billion. Of this some \$100 billion is specifically identified as being for construction related projects, and there are many other provisions related to loan guarantees, non-construction spending, and tax changes that could generate far more construction spending over time. In context, the US Census Bureau estimates the total value of construction put in place in 2008 at \$1,078 billion, roughly \$60 billion lower than 2007.

Counterbalancing the magnitude of the spending, however, is the reality of getting that much work into the market. Much has been made of finding 'shovel ready' projects, but the reality is that the expenditure will take time to occur. Even for projects that are fully designed and permitted, the procurement and contracting process will typically take three to four months to complete. Much of the work will take far longer. The Congressional Budget Office (CBO) estimates that less than a quarter of the construction spending will occur in Fiscal Year 2009, and less than half by the end of Fiscal Year 2010. At best, this means that the direct input from the stimulus spending to the construction market is likely to be in the range of \$30 to \$50 billion, appreciably less than the shrinkage in 2008. Even allowing for the impact of the indirect provisions of the act, the stimulus is unlikely to lead to strong growth in construction activity in 2009. If anything, however, it should at least slow the extent of contraction, and provide some stability to the falling construction prices.

In 2010 and beyond, when more of the work comes on line, the impact could be greater, especially as the broader economy starts its recovery. Even if, as expected, private sector construction is one of the later sectors of the economy to recover, it is possible that the volume of construction due

to the stimulus and the recovery will create demand stresses similar to those experienced in 2006 and 2007, leading to increased demand side escalation in construction. This could be particularly strong if a significant number of construction and design firms fail during the recession.

All of this, however, is dependent on the success of other aspects of the government's economic recovery program, in particular the restoration of the financial markets. While the direct spending of the ARRA will create jobs, the jobs will not be sustainable without recovery in demand from the private sector, and from states and other local governments. This can only happen if liquidity returns to normal levels. At present, there are some slight indications that the credit markets may be opening somewhat. Bond issuance in January grew modestly, but there is still a long way to go, and for now, there is no way of knowing how quickly the markets will recover.

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## The American Recovery and Reinvestment Act of 2009

The American Recovery and Reinvestment Act of 2009 (ARRA) is one of a series of administrative and legislative actions intended to reduce the effects of the current recession, and to stimulate economic activity. Construction and construction related activities make up a large portion of the spending appropriated by this act, both in the direct expenditure of funds for construction for buildings and infrastructure, and in the indirect effect of the loan guarantees, non-construction spending, and tax provisions of the act. There are two parts to the act: Division A includes spending provisions and Division B, tax provisions.

### Construction Volume

It is not possible to quantify the total value of funds allocated for construction since, in many cases, it is included as part of a larger appropriation, or undefined as part of a wider program goal. For example, the ARRA provides for \$4.5 billion for the Electricity Delivery and Energy Reliability program, but it is not evident how much of this will be for acquisition of rights of way, how much for equipment, and how much, if any, for construction.

It is also difficult to assess the magnitude of the indirect impact of the act. The ARRA includes substantial sums for loan guarantees in a wide range of programs, and these loan guarantees are intended to support far greater sums in actual loans. For example, the act includes \$130 million for loans and grants for rural community facilities, which is expected to support \$1.2 billion in loans and grants for 'essential rural community facilities including hospitals, health clinics, health and safety vehicles and equipment, public buildings, and child and elder care facilities'. In addition to the loan guarantees, many other appropriations could well trigger construction activity. For example, the National Science Foundation has an appropriation of \$2.5 billion. While only \$200 million of this is explicitly identified as being for construction activity, it is likely that the remainder will trigger additional construction.

In addition to the direct and indirect expenditures in Division A of the act, Division B enacts a wide range of tax provisions, among which are many that could lead to increased construction activity. These range from

renewable energy credits, expanded opportunities for state, local, and tribal governments to issue tax-exempt bonds, fiscal relief funds for states, and increased business investment deductions. Many of these provisions act in support of, but do not directly fund, investment. As such, their impact is highly dependent on the availability of funding from other sources. If businesses and state, local or tribal governments cannot raise the necessary funds, the tax provisions will have no stimulating effect.

Overall, the total value of construction is likely to be in the range of \$120 to \$170 billion over a period of four to six years.

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### Speed to Market

The ARRA is very clear in stating that its goal is rapid deployment of the funds, requiring commencement of “. . . expenditures and activities as quickly as possible consistent with prudent management”, with “. . . a goal of using at least 50 percent of the funds for activities that can be initiated not later than 120 days after the date of the enactment of this Act.” Throughout the act, there is reference to rapid deployment of the funds, often referring back to the 120 day requirement for expenditure.

In contrast, the Congressional Budget Office (CBO), in its analysis of the original bill (HR 1), anticipates a far slower rate of expenditure, commenting that “. . . in the past, in all types of federal programs, a noticeable lag has occurred between sharp increases in budget authority and the resulting increases in outlays. Based on such experiences, CBO expects that federal agencies, along with states and other recipients of that funding, would find it difficult to properly manage and oversee a rapid expansion of existing programs so as to expend the added funds as quickly as they expend resources provided for their ongoing programs.”

The reality is likely to lie somewhere between the two. It is difficult to visualize successful commitment of fifty percent of the funds within 120 days, and it is unlikely that this could be accomplished in a manner consistent with ‘prudent management’, particularly given the act’s requirement that all work be procured through traditional competitive bidding, except in very specific circumstances. On the other hand, it is unlikely that procurement as slowly as anticipated by CBO would be acceptable to Congress or the Administration.

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## Stimulated Spending

Another major factor to consider is the degree to which the stimulus package stimulates other economic activity. Clearly the intention is not only to create jobs through direct government spending, but also to address the widespread lack of confidence in the economy, and to encourage both consumer spending and business investment. In many respects, this is beyond the scope of ARRA.

The most critical aspects of restoring consumer and business confidence lie in addressing the financial markets, in particular the mortgage and housing price crisis for consumers, and liquidity crisis for business. As can be seen from the data below, the securitized debt issuance in 2008 fell sharply, particularly for asset backed securities.

*Without resolution in the areas of consumer confidence and credit liquidity, the ARRA will have little long-term effect on the economy. Currently, these problems seem far more intractable, and while government actions in September and October last year appear to have stabilized the US financial markets, recovery in the sector appears to be some way off. There are several proposals currently in development, including mortgage foreclosure relief, and additional treasury activity to buy up troubled assets or fund bank capital, but for the most part the proposals are still fairly sketchy, and their impact is far from clear.*

