The Effects of the Recession on the United States:

A focus on the Housing Market, Automobile Industry, Small Business and Government Spending

Team No Names

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Professor Matsuda

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The United States economy has seen a serious economic downturn from 2007 to present. As economists and politicians race to find possible solutions to fixing our economy, the housing market and automobile industry are suffering greatly—pushing the economy into even further recession. Across the nation, small businesses are fighting to stay afloat as the cost of business is steadily rising. Meanwhile, government spending is increasing which is also contributing to nationwide debt. In this paper we will discuss what caused the collapse of the housing industry, the effects its downturn has played on the United States, and also we will provide a solution to the problem. We will also discuss what has driven the automobile industry to its low and how that has affected the nation, along with a solution for the current problem. The issue of the effects of the recession on United States small businesses will also be addressed. Lastly, we will discuss the present crisis of government spending.

For over the last year and a half, news of bad economic conditions has flooded the media. It is no secret that the housing industry has suffered significantly, if not the most in the United States recession. As a result, the housing industry has taken a large portion of the blame for the current financial situation.

It is evident that the current housing conditions can be attributed to how many "subprime" mortgages or the riskiest types of loans, which usually are financed to bad credit borrowers—were approved. According to Fisher (2008), in many situations, these mortgages were granted to people who could not afford them. Many times these loans also consisted in no down payments, no verified income estimates, and low teaser rates to lure consumers in. To add to this, homebuyers attracted to these low interest rates faced serious financial trouble after rates spiked to meet the market demands. Fisher (2008) noted, "it is questionable whether or not these mortgages were sound loans, even when people could refinance". As home prices started falling, millions of people defaulted on their loans—which resulted in a ripple effect across the nation (Fisher, J, 2008).

According to Downs (2009), it appears that the housing industry has experienced two major contributors to the recession. The first, as mentioned above, was a high amount of precarious loans which often ended in defaults. As more loans were being approved, home builders began building new houses that eventually exceeded the demand (Downs, T, 2009). As prices began falling debt grew—which led banks into serious trouble.

The second major pitfall was the steady rise in unemployment. Consumers cut back on spending—especially on large investments—with fears of losing their jobs, decreasing home-value, and diminishing retirement plans. According to *Real Estate Recession is Far From Over*, this issue is similar to what has happened in the housing industry during most previous recessions. Unlike the effects of the first major cause, the results of the rise in unemployment have not played out, as unemployment is still a major issue in the U.S. (Downs, T, 2009). Because of this, it is difficult to predict how soon the housing industry will be restored to its norm.

Foreclosures have broken records going back almost 30 years. Unfortunately, in many areas homes are selling at ridiculous discounts—"almost 30% less than they were at their peak in the summer of 2006" (The Residential Real Estate Market: Bad News and Good News, 2009). Though this can be good for homebuyers, and it may stimulate interest in purchasing a new home; however, it is not good for those who are trying to sell houses and are losing mass amounts of money.

U.S citizens are also losing home equity wealth as a result of foreclosures in close neighborhoods or developments. According to *The Cost of Bad Lending in Ohio*, “home equity lost in Ohio due to nearby foreclosures is estimated to be 1.9 trillion between 2009 and 2012. Total foreclosure projections for 2009 to 2012 will be roughly 282,190 in Ohio” (The Cost of Bad Lending in Ohio, 2010).

In 2008, The Housing and Economic Recovery Act was passed by Congress to make living for the middle class more affordable (H.R. 3221, the Housing and Economic Recovery Act of 2008, 2008). As citizens struggled from higher prices, lower wages and even job loss, this act helped to offer relief and somewhat stabilize the market. The Housing and Economic Recovery Act also enacted several other acts to help the economy.

> The Treasury Emergency Authority Act was designed to restore confidence in U.S financial markets such as Fannie Mae, Freddie Mac and federal loan banks.
>
> The HOPE for Homeowners Act gave the FHA new incentives to prevent further foreclosures of up to hundreds of thousands of Americans. These incentives were of no expense to American tax payers.
>
> The S.A.F.E Mortgage Licensing Act created a federal registry and enacted minimal national standards for residential mortgage brokers and lenders.
>
> The Foreclosure Prevention Act provided assistance for especially hard hit areas with high concentrations of foreclosures. This act made available counseling for victims of foreclosure and even supports groups for returning soldiers to avoid foreclosure. Programs were also set up for FHA modernization and mortgage disclosure enhancements.

The Housing and Economic Recovery Act of 2008 also led to the establishment of The Housing Assistance Tax Act of 2008, (H.R. 3221, the Housing and Economic Recovery Act of 2008, 2008) which provided tax benefits for homeowners, homebuyers, and homebuilders that helped to revive the economy. “This act provided $15.1 billion in tax incentives, including a credit for first-time homebuyers, a standard deduction for property taxes, and an increase in the low-income housing tax credit” (What is the Housing Assistance Tax Act of 2008?, 2010).

We feel the best solution to the current housing situation is to modify bank loans and mortgages. If banks would modify the loan terms, the majority of at-risk borrowers could pay their mortgages and stay in their homes. This would result in less foreclosures and ultimately ending in less unpaid debt expenses. In turn, this would lead to less depreciation in home equity, which would mean more income for Americans. As American income and GDP rise, this would eventually result in higher spending which would boost not only the housing industry but also the overall economy.

Despite the housing market's negative effects on the economy, the automobile industry is not helping the cause. The automobile industry has suffered a major blow in recent years as Americans are less likely to make large investments for fear of financial trouble. Just as borrowers fear defaulting on mortgages, those looking to purchase vehicles are also fearful of going into debt. This is a major problem for the U.S automobile industry. Another major issue is that Americans are buying foreign models due to better gas mileage and sleeker design, rather than sticking with the domestic automakers such as Ford, GM, and Chrysler.

The global financial downfall has greatly influenced the automobile industry. It has affected European, Asian, but mostly it is taking its toll on the American automobile industry. A major cause to this decline in the automobile industry was the increase in fuel prices. This increase in fuel prices led to a decline in sales of SUV's (sport utility vehicles) and pick-up trucks. The "big three" auto-makers in the United States, Chrysler, General Motors, and Ford all invested a lot of money into SUV and truck production(Automobile Industry, 2008). These types of vehicles brought in the most revenue and had very high popularity before the fuel prices increased. Once the fuel prices went up the companies had almost no fuel efficient cars to offer the public, and thus sales began to decline. In 2007 the sales of trucks and SUV's declined dramatically, almost 3 million less sales (Automobile Industry, 2008). In 2009 things were much worse, the sales declined by almost 6 million, and almost 1 million of the sales that these companies did make, were results of the "cash for clunkers" program. In this terrible time for the industry two major companies filed for bankruptcy—GM and Chrysler. GM and Chrysler received $17.4 billion in aid from the U.S. (Automobiles and Trucks Trends, 2010).

In May 2009 GM announced that it would close about 1,100 dealerships, which means it would only have about 3,600 dealerships remaining. These dealerships would sell Chevy, Cadillac, Buick and GM automobiles. It also was expected to eliminate about 470 further dealerships by selling its Saab, Hummer and Saturn units. Then GM filed for bankruptcy in mid-2009, and was only put back in business because of a massive federal bailout (Automobile Industry, 2008).

The auto mobile industry is responsible for 25 million jobs worldwide and the U.S. is the largest producer and consumer of automobiles. It offers 6.6 million jobs directly and in directly. General motors' alone is the largest automobile producer in the world. It manufactures auto mobiles in over 30 countries; GM provides products for over 140 countries and provides jobs for over 250,000 people (Automobile Industry, 2008).

Ford Motors is second in United States auto-makers, and fourth in the world. It has hundreds of plants around the world and just fewer than 250,000 employees (Automobile Industry, 2008).

Ford Motors and GM, along with Chrysler, control much of the automobile industry worldwide and when the recession hit these American powerhouses, it greatly affected other countries around the world.

On January 26, 2009; a day called "Bloody Monday," 71,400 Americans lost their jobs. The reason for this was the global crisis. It struck the world towards the end of 2007. In December 2008, The National Bureau of Economic research (NBER) stated that the US had been in recession since December 2007 (Automobile Industry, 2008).

By the middle of 2008 every industry was affected; including car insurance. Due to high prices in cars, and nearly every other domestic good for that matter, citizens were finding ways to cut back on costs. One way to limit costs was to cut back on insurance. The decline of citizens buying car insurance led to an adverse decline in the automobile industry.

Both the current housing issue and problems within the domestic auto industry are causing the United States' economy to decline rapidly. A major result from the poor economy has caused both large and small businesses to struggle to stay in business. Though big businesses are still having problems, small businesses are suffering on a grander scale.

It is evident that during the recent years past, our nation has been crippled by a recession that has left many small business owners wondering what can be done to keep their businesses alive. In America, small businesses are the backbone of our society. They account for more than 99% of the total number of businesses that are currently established in this country, and in turn are responsible for the employment of almost 50% of the working population. These are extremely large numbers to have invested on one particular niche in the economy. With the crippling affect that this recession has placed on the American people, it is easy to see how small businesses owners have struggled. So specifically, how has the current recession affected small businesses and their owners?

Overall, small businesses are very hard to establish, especially without the current pressures of the economy that the United States has had to withstand over the past four years. In an analysis done by Patricia Schaefer (2006), it was found that 44% of small businesses fail within the first two years of their inception. Judging by this number and keeping in mind the harsh times that society is facing economically, it is safe to stay that this number has increased even more in the past few years. The incredibly high rate of crumbling small business can be narrowed down to a few different factors.

The first factor, according to More Business (2009) that can put a small business in the red is the increasing number of exorbitant credit card debt that owners are accumulating. With a recession comes inflation, especially on products that are of everyday use to business owners. This hurts people who use credit cards repeatedly because the price of a product may increase without the card user even knowing. In turn, there is general misunderstanding by the owner as to why he is not turning out any profit, until he looks at the credit card statement and realizes that inflation has had a complete negative effect on business (More Business 2009). This is not the only factor that plays a role in the demise of a small business.

Another issue that business owners are faced with is the growing problem of customer interest dwindling. "More Business" (2009) views this problem in two different scenarios. The first is the problem with customers having decreases in discretionary spending. This hurts small business owners that depend on these customers for the purchase of items that keep businesses afloat. Additionally, loyal customers that have been buying from these small businesses for years are starting to tighten up their spending to try and cover other expenses that they must pay for to run their business (More Business 2009). With these two issues arising, it is simple to see that a business would struggle if they were dependant on customers that had been purchasing from them for years. Still, there are other aspects that can cripple a business.

A third issue is results from small business owners borrowing too much for mortgages on property, and not being able to acquire the cash to make new payments. According to “Small Business (2009), lenders steadily hike up interest rates on properties, because they too are struggling to make profit. Even after a mortgage is about to expire, owners have a hard time finding new lenders that are willing to offer a new, lower rate (Small Business 2009). This makes it difficult with a tight budget, because most small business owners have a hard time paying for utilities and the land that must be used to run a successful business.

Bankruptcy has also been a huge cause in the closing of small businesses during the current recession. In an article written by Scott A. Shane (2009), he looks at how bankruptcy has been at the forefront of the devastation of small businesses in the United States. The number of bankrupt small businesses had been on a steady incline starting in 2006, but as one can see in Figure 1, the numbers began to skyrocket when the recession became more and more of a dynamic. These numbers are astounding when thinking about how many jobs have been lost because of these bankruptcies. Small businesses closing have more than doubled since the third quarter of 2007 (Shane 2009). These numbers will continue to rise, especially if changes are not made within the system to help these small businesses cover new expenses, and old debts.

Small business lending has also dwindled since the start of the recession. In a report done by the New York Times (2009), it was reported that banks lending to small businesses cut their expenditures by $12.5 billion during a seven month span that ended in November 2009. This meant that there was a 4.6% decrease in lending overall by 22 of the largest banks in the country. Even more, the two largest lenders, Wells Fargo and Bank of America, reduced their lending by 4.4 and 6.2 respectively (New York Times 2009). With no money being lent to small business owners, how is it possible to churn out a profit and keep a steady flow of cash for an establishment? The answer is there is not. Without sufficient funds being lent by banks, small business owners cannot fund simple expenditures like paying the electricity bill, let alone expanding into new markets.

There are businesses that have thrived during this recession period. According to an article published by John W. Schoen, a producer at MSNBC (2009), there are a few companies that can make it strong through recessions. For example, the health care industry will always do well, because people are always sick. Another example is a funeral home or an accountant. There are two things in life that are certain, death and taxes. That is one of the main reasons that people like funeral home directors and certified public accountants can turnover great profit during a recession. In addition, dry cleaners, pawn shops, and car insurance agents also turn in good profits during hard economic times (Schoen 2009).

Other ways to make money can be found for profit turnover. In an article by Jean Murray (2008), she talks about five ways to make profits with business ideas during hard times. One example would be to offer things that people must have. These would include providing things like food, shelter in clothing, because people will always need these necessities. Another would be offering things that people think that they need to have. Everyone has addictions, so if business owners can find a way to market products to these customers, they can make a substantial profit. One final thought is offering "Make –Do" things to customers. These would include skillful things like fixing cars, doing carpentry, or possibly plumbing work for people the person knows (Murray 2008). Skilled labor is always needed, because most people are not able to do everything themselves.

A study done by Sage Works (2008) shows the ten most profitable industries of the year—according to growth. In figure 2, it can be seen the dental industry saw the most growth over the past year at 16.96% (Sage Works). This can be because of the fact that people always have to have oral hygiene, and there are not a lot of dentists. Another industry that saw substantial growth was support activities for mining. This industry spiked by a surprising 11.93% Sage Works). This could be tied into finding alternate energy sources to try to find cheap ways to use energy.

It is clearly evident that small business has been negatively affected by the recession that has taken over the United States. It will be a long and tenuous process to fix the crippled state that has been thrown at small business owners. With the governments help, and customers continuing to spend money on products that small businesses provide, there is a light at the end of the tunnel. Though it will be extremely difficult for small businesses to stay afloat in the next quarters to come, it is possible.

It appears that the United States currently faces an economic frenzy that fuels itself. As the housing market crumbles, Americans become more afraid to spend money, which in turn affects both the automobile industry and small U.S business—as Americans search for lower prices, more efficient vehicles and are more reluctant to spend money. As a direct result of this, government spending has increased ergonomically in recent years.

Since the recession has begun, it is clear that government spending has been on a steady rise over the past couple of years. Obama's recently introduced stimulus package was created to help the economy come out of the recession, although it cost billions of dollars itself. It is obvious that the recession and government spending are directly related. As the recession continues to rise, so will government spending. Conversely, when the recession slows down, we should see a decrease in the amount of government spending. This is what should happen theoretically speaking of course.

It is clear to see why the recession would increase government spending. The government cannot sit idly by while the country suffers, and in order to generate money back into the economy, money has to first be spent. According to the Bureau of Labor Statistics, the unemployment rate was 7.7 percent in January of 2009 and that percentage rose to 10 percent by December 2009 (United States Department of Labor, 2010).

As a result of the rising unemployment number, President Obama has taken action to not only to create more jobs, but also to grant aid to those currently unemployed by providing them with more benefits than ever before. In February of 200, Obama signed a billion dollar stimulus plan in which the issue of unemployment was not forgotten. On a article posted on Glen Beck website, the stimulus plan was written to include, "$43 billion for increased unemployment benefits and job training, $39 billion to support those who lose their jobs by helping them to pay the cost of keeping their employer provided healthcare under COBRA and providing short-term options to be covered by Medicaid, and $20 billion to increase the food stamp benefit by over 13% in order to help defray rising food costs" (Beck, 2009).

In addition to doing this, Obama is also giving tax cuts to small businesses that create more jobs. It has also been reported that the job openings rate changed very little in December at 1.9 percent. The rate has been 1.8 percent or 1.9 percent since March 2009. In December, the job openings rate increased in state and local government and decreased in the Midwest (United States Department of Labor, 2010). The spending the government has recently been doing on trying to improve the unemployment issues stems from a direct result from the recession.

Due to the rising number of Americans who are now unemployed, or have had to take a cut in their paycheck, the number of citizens with adequate healthcare coverage has also suffered tremendously. There are currently millions of Americans either without healthcare coverage or suffering from inadequate coverage. As stated by Steven Reinberg (2009), a reporter for Healthday, "An estimated 14,000 Americans are losing their health insurance each day during the recession". In his stimulus plan, Obama dedicated billions of dollars to focus on the growing healthcare problem. A pricy $39 billion is to go to subsidies to health insurance for unemployed; providing coverage through Medicaid, another $87 billion to help to states with Medicaid, $20 billion to modernize health-information technology system, and finally $4.1 billion is to go towards preventative care (Reinberg, 2009). Healthcare is clearly a more pressing issue than unemployment because the government is spending billions more on taking care of healthcare issues. Reinberg also reported that, "by 2018 health care spending is projected to reach $4.4 trillion — accounting for 20.3 percent of the U.S. gross domestic product (GDP). In 2008, health care spending reached 16.6 percent of GDP. In 2009, health care's share of GDP is expected to reach 17.6 percent of GDP, the largest one-year increase ever seen, the report said (Reinberg, 2009)

Another issue that America currently faces lies within the housing system, as previously mentioned. Many houses are decreasing rapidly in value and many American have mortgages that they cannot afford. As recorded on a fact sheet from The White House's official website, "in some studies, foreclosure on a home has been found to reduce the prices of nearby homes by as much as 9 percent – creating the potential that even borrowers who make every payment suffer from an increase in foreclosures in their community" (The White House, 2009).

Obama's administration has also had to work overtime to resolve this issue. This is how the Homeowner Affordability and Stability Plan came about. The plan will offer assistance to as many as 7 to 9 million homeowners making a good-faith effort to stay current on their mortgage payments, while attempting to prevent the destructive impact of foreclosures on families and communities. It also will provide up to 4 to 5 million homeowners with new access to refinancing and enacting a comprehensive stability initiative to offer reduced monthly payments for up to 3 to 4 million at-risk homeowners (The White House, 2009).

Obama is not the only president to have increased government spending in order to combat the effects of the economy. Increasing government spending during a recession is on some level necessary. As stated by Brian M. Riedl, reporter for The Wall Street Journal,

> During the 1930s, New Deal lawmakers doubled federal spending--yet unemployment remained above 20 percent until World War II. Japan responded to a 1990 recession by passing 10 stimulus spending bills over 8 years yet its economy remained stagnant. In 2001, President Bush responded to a recession by "injecting" tax rebates into the economy. The economy did not respond until two years later, when tax rate reductions were implemented. In 2008, President Bush tried to head off the current recession with another round of tax rebates. The recession continued to worsen (Riedl, 2010).

The last question that must be asked as a result from all these governmental increases in spending during recessions is, “Does it work?” Riedl (2010) writes that, “From where does the government acquire the money it pumps into the economy? Congress does not have a vault of money waiting to be distributed. Every dollar Congress injects into the economy must first be taxed or borrowed out of the economy. No new spending power is created. It is merely redistributed from one group of people to another” (Riedl, 2010). From the previous attempts, it would seem that increased spending either does nothing for the economy, or simply made it worse. Riedl also writes that, “First, if money is not going to be printed, it has to come from somewhere. If the government borrows a dollar from you, that is a dollar that you do not spend, or that you do not lend to a company to spend on new investment. Every dollar of increased government spending must correspond to one less dollar of private spending. Jobs created by stimulus spending are offset by jobs lost from the decline in private spending (Riedl, 2010).

It is hard to provide a definite solution to reduce government spending in our current economy. Though government spending could be cut back, the government is the only sector that has nearly enough money to restart the economy. The United States will never come out of recession if money is not being spent to revive business domestically. Once business picks back up, job openings will increase and conversely, unemployment levels will fall. Once this occurs it can be assumed that the housing and automobile industries will also bounce back. So for now, our solution is to cut back on government spending in minor sectors such as public roadways and transportation, for example, and continue spending in major areas such as stimulus packages for suffering American tax-payers.

In conclusion, though the United States faces one of the biggest recessions of its history, there is hope that there will be a turn around. Despite this, one cannot ignore the major issues that America faces during the current economic strife. The housing industry has seen foreclosure rates at a significantly higher level than the past three decades. As foreclosure and defaulting is on the rise, many Americans are going into debt—which in turn sends the economy further down the drain. The automobile industry is also currently struggling as domestic car companies are losing sales to foreign makers and high fuel costs. The government has had in intervene within the automobile industry as sales have hit near rock bottom. With the major decline in auto sales comes job cuts and wage reductions, which also drive down household income and instill fear in Americans to make monetary investments. This in turn is a serious problem for small businesses nationwide. Due to low sales revenue, small business are finding it difficult to pay for simple things that were never a problem before—such as electricity bills and rent for instance. It appears that the current economic condition in the United States is simply a vicious cycle of debt. The housing and auto industries are lowering American income and adversely increasing government spending.  The mountain will be hard to climb, but the United States has proven strong during previous times of economic contention. Therefore, there is no reason to believe that this recession too, will pass.

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