

## What Do We Know About the Effect of Fiscal Stimulus Measures?

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The understandable temptation to take action during a crisis should not lead lawmakers to take counterproductive actions. In response to the financial crisis, Congress passed the American Recovery and Reinvestment Act (ARRA) in February 2009, which totaled \$789 billion in government spending and tax cuts. President Obama reassured anxious Americans that this spending would "revive our economy" and "create 3.5 million jobs" over the next two years.<sup>1</sup> Since then the US economy has shed another 3.1 million jobs and the unemployment rate has climbed to 9.5%. That's higher than the White House predicted it would have reached even *without* the stimulus. Examining the actual data shows us that fiscal stimulus doesn't work.

### RESEARCH FINDINGS

- **Does government spending create economic growth?** A new study by Harvard professor Dr. Robert Barro and Charles Redlick tests the claim that government spending creates economic growth by using defense spending as a proxy for overall government spending.<sup>2</sup> Their research finds that greater government spending does not aid the economy; in fact, it causes decreased consumption and investment. This effect on gross domestic product of an increase in government spending is called *the multiplier effect*.
- **A dollar spent is not a dollar created.** Barro and Redlick explain the historical value of the multiplier in the United States. Their work shows that in the best case scenario, a dollar of government spending produces much less than a dollar in economic growth—between 0.40 and 0.70 cents. If that were the return on our private sector investments, America would not be the economic engine of the world.
- **What about funding government spending with taxes?** Barro also calculates the impact on the economy if the government funds the spending with taxes. He found that if the government spends \$1 and raises taxes to pay for it, the economy will shrink by one dollar and 10 cents. In other words, greater spending financed by tax increases hurts the economy.
- **Why does the multiplier matter?** Getting the multiplier effect wrong has big consequences when understanding the effects of fiscal stimulus on the economy. The government uses multipliers to estimate the widely cited projections of unemployment, job creation, and economic output. In the time leading up

<sup>1</sup> Barack Obama, "Address to Joint Session of Congress" (speech, The United States Capitol, Washington, D.C., February 24, 2009), [http://www.whitehouse.gov/the\\_press\\_office/remarks-of-president-barack-obama-address-to-joint-session-of-congress/](http://www.whitehouse.gov/the_press_office/remarks-of-president-barack-obama-address-to-joint-session-of-congress/).

<sup>2</sup> Robert Barro and Charles Redlick, "[Macroeconomic Effects from Government Purchases and Taxes](#)" (working paper, Mercatus Center at George Mason University, Arlington, VA, July 2010).

to the passage of the ARRA, Council of Economic Advisors (CEA) economists Christina Romer and Jared Bernstein used spending multipliers greater than 1 to promote the economic effects of the fiscal stimulus package.<sup>3</sup> In the months following the implementation of this package, the Congressional Budget Office (CBO) used estimates of a spending multiplier between 1.0 and 2.5,<sup>4</sup> relying on macroeconomic models that ignore the possibility that the growth of the economy may be affecting the level of government spending and not the reverse.<sup>5</sup> By extrapolating from these multipliers, CBO and CEA have made important projections about the effects of fiscal stimulus on the economy. These projections, however, have been largely wrong.

- **What about the data?** Using the tens of thousands of stimulus recipient reports published on recovery.gov each quarter and economic and political data from the Bureau of Labor Statistics, the Census Bureau, GovTrack.us and others, Dr. Veronique de Rugy has found:
  - The total number of jobs claimed from the stimulus is 682,000.
  - 4 out of 5 jobs were created in the public sector not in the private sector.
  - The average cost of each job created or saved is \$282,000.
  - While you would expect that the government would invest relatively more money in districts that have the highest unemployment rates and less money in districts with lower unemployment rates, this does not appear to be the case. The data shows no correlation between how the money is spent and unemployment rates<sup>6</sup>

## OPPORTUNITIES FOR CHANGE

- **What should we do?** The first step toward real job creation is for government to acknowledge its limitations. Private businesses are the true drivers of job creation; they flourish when they have a reasonable expectation that the government will be noninvasive, non-burdensome, and fiscally responsible. By creating a stable economic environment and eliminating uncertainty, the federal government would do more to aid job creation than any stimulus package could.

## ABOUT DR. DE RUGY



Veronique de Rugy is a senior research fellow at the Mercatus Center. Her research interests include tax and fiscal policy, the federal budget, homeland security, and financial privacy issues. She was previously a resident fellow at the American Enterprise Institute, a policy analyst at the Cato Institute, and a research fellow at the Atlas Economic Research Foundation.

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*The ideas presented in this document do not represent official positions of the Mercatus Center at George Mason University.*

<sup>3</sup> Romer and Bernstein, "The Job Impact of the American Recovery and Reinvestment Plan," 12.

<sup>4</sup> Congressional Budget Office, *Estimated Impact of the American Recovery and Reinvestment Act, January 2010 through March 2010* (Washington, DC: Congressional Budget Office, May 2010), <http://www.cbo.gov/ftpdocs/115xx/doc11525/05-25-ARRA.pdf>.

<sup>5</sup> Ibid, appendix. For an example of models operating under similar assumptions, see R. C. Fair, "Estimated Macroeconomic Effects of the U.S. Stimulus Bill," unpublished, Yale University, March 2010.

<sup>6</sup> Veronique de Rugy, Jakina R. Debnam, *Stimulus Facts Data*, (Mercatus Center at George Mason University, Arlington, VA July 14, 2010). <http://mercatus.org/publication/stimulus-facts-data>