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THE ESSENTIAL STIMULUS: LESSONS FROM THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

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On February 13, 2009, President Obama signed into law the American Recovery and Reinvestment Act (ARRA), popularly known as the “stimulus.” Divided into three main pieces—$288 billion in tax benefits such as a refundable tax credit; $272 billion in contracts, grants, and loans (the “shovel-ready” projects); and $302 billion in entitlements such as food stamps and unemployment insurance—the $787 billion stimulus came with several promises.[1]

The administration promised that ARRA would “create or save” 3.5 million jobs over the next two years, mostly in the private sector.[2] The administration also promised that under ARRA not only would unemployment not increase beyond 8.25 percent, but that it would also drop to 7.25 percent by end of 2010.[3]

The administration argued that spending $787 billion would have this effect because when government spends money where it is most needed, that expenditure creates jobs and triggers economic growth. The administration assured skeptics that it would spend the money in a good Keynesian fashion: the spending would be timely and temporary.[4] It also explained the reason that the returns on government spending would be so high: for every dollar the government spent, the economy would grow by 1.57.[5]

ARRA’S FAILED PROMISES

Unfortunately, the stimulus has failed to live up to the promises:

- The Council of Economic Advisors (CEA) tallies the sum of the stimulus bill’s outlays and tax cuts at $666 billion and asserts that ARRA saved or created somewhere between 2.4 and 3.6 million jobs as of the first quarter of 2011.[6] Using the CEA’s estimates, the cost of job creation ranges from $185,000 to $278,000 per job. However, these numbers are highly theoretical as the CEA does not base its job numbers on any true count of jobs, which has caused many studies to question these figures.[7] Moreover, contrary to the administration’s promise, a majority of the jobs created were in the public, rather than the private, sector.[8]

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[1] “The Recovery Act,” Recovery.gov, http://www.recovery.gov/About/Pages/The_Act.aspx.
[2] The White House, “American Recovery and Reinvestment Act: State-by State Jobs Impact,” White House Website, February 13, 2009, http://www.whitehouse.gov/assets/documents/Recovery_Act_state-by-state_jobs_2-131.pdf; and Christina Romer and Jared Bernstein, “The Job Impact of the American Recovery and Reinvestment Plan,” January 2009, http://otrans.3cdn.net/45593e8ecbd339d074_l3m6bt1te.pdf.
[3] Ibid., 4.
[4] Ibid.
[5] This prediction was based on an estimate of a government purchases multiplier (the “multiplier”) of 1.57 that was prepared by presidential advisors Christina Romer and Jared Bernstein. (The multiplier measures the amount by which the economy expands when the government increases its purchases of goods and services by $1.00.) Ibid.
[6] Council of Economic Advisors, *The Economic Impact of the American Recovery and Reinvestment Act of 2009*, *Seventh Quarterly Report* (Washington, DC: CEA, 2011), 2, http://www.whitehouse.gov/sites/default/files/cea_7th_arra_report.pdf.
[7] Russell Roberts, “The Stimulus: Two Years Later,” Testimony Before the House Committee on Government Oversight and Reform, Subcommittee on Regulatory Affairs, Stimulus Oversight and Government Spending, February 16, 2011, http://mercatus.org/publication/stimulus-two-years-later.
[8] The White House, “American Recovery and Reinvestment Act: State-by State Jobs Impact.”

- Unemployment has lingered above 9 percent for months.[9]

- ARRA expenditures have been increased from $787 billion to $840 billion to be consistent with the president's 2012 budget.[10]

WHY DID ARRA FAIL?

Despite the many promises connected to ARRA, the economy hasn't recovered and remains sluggish.[11] Why did ARRA fail to fulfill the administration's promises about its projected effects? There are two main reasons.

Misplaced Multipliers

Contrary to some media reports, not all economists agree that government spending can jumpstart the economy. The academic profession is divided about the true value of the multiplier.[12] Some economists find large multipliers (e.g., 3.8); some find negative effects (less than 0).[13] The administration's estimate of 1.57 falls on the high end of this spectrum and is certainly higher than the median (0.87) as measured by my colleague Matthew Mitchell.[14] This 0.87 median means that in, most cases, a dollar in government spending produces less than a dollar in economic growth. Government spending actually *retards* growth. And these findings often don't even take into account the effect of paying for that government dollar via increased taxes.

Implementation Issues

Maybe more importantly, even if the multiplier were actually 1.57, the design of the stimulus bill was such that it could not have stimulated anything. Several implementation problems exist with ARRA:

- The spending went to the public not the private sector. States have used much of the money to close their budget gaps, which often means keeping union-protected school teachers in their jobs and paying for public sector jobs, rather than creating jobs in the private sector.[15] Thus, stimulus spending in the states defers rather than mitigates the economic impact of the recession.[16]

- The spending wasn't timely. According to the GAO, as of June 2011, of the $45 billion in infrastructure money to be spent through the Department of Transportation, 95 percent had been appropriated but only 62 percent (or $28 billion) had been spent,[17] probably because, as even President Obama conceded in October 2010, "there's no such thing as shovel-ready projects."[18]

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[9] Veronique de Rugy, "President's Estimates Versus Actual Unemployment after Stimulus," chart, Mercatus Center at George Mason University, September 8, 2011, http://mercatus.org/publication/presidents-estimates-versus-actual-unemployment-after-stimulus-0.

[10] "Where Is the Money Going?: Breakdown of Funding," Recovery.gov, http://www.recovery.gov/Transparency/fundingoverview/Pages/fundingbreakdown.aspx.

[11] Bureau of Economic Analysis, "Gross Domestic Product: Second Quarter 2011 (Second Estimate) and Corporate Profits: Second Quarter 2011 (Preliminary)," news release, August 26, 2011, http://www.bea.gov/newsreleases/national/gdp/2011/pdf/gdp2q11_2nd.pdf.

[12] See Eric Leeper, Todd Walker, and Shu-Chum Yang, "Government Investment and Fiscal Stimulus," (working paper, International Monetary Fund, October, 2010), http://www.imf.org/external/pubs/ft/wp/2010/wp10229.pdf.

[13] For a high estimate, see Lawrence Christiano, Martin Eichenbaum, and Sergio Rebelo, "When is the Government Spending Multiplier Large?" (working paper, Northwestern University, Chicago, IL, 2009), http://faculty.wcas.northwestern.edu/~yona/research/Multiplier-version12.pdf. For a low estimate, see Andrew Mountford and Harald Uhlig, "What are the Effects of Fiscal Policy Shocks?" *Journal of Applied Econometrics* 24, 6 (2009): 960–92, http://onlinelibrary.wiley.com/doi/10.1002/jae.1079/full.

[14] Matthew Mitchell, "Is More Stimulus the Answer?" (working paper, Mercatus Center at George Mason University, Arlington, VA, forthcoming).

[15] Veronique de Rugy, "The State of the Stimulus," The Corner, *National Review*, November 10, 2009, http://www.nationalreview.com/corner/189993/state-stimulus/veronique-de-rugy.

[16] John F. Cogan and John B. Taylor, "What the Government Purchases Multiplier Actually Multiplied in the 2009 Stimulus Package," NBER Working Paper No. 16505, October 2010.

[17] Government Accountability Office, *Recovery Act: Funding Used for Transportation Infrastructure Projects, but Some Requirements Proved Challenging* (Washington, DC: GAO, 2011), http://www.gao.gov/new.items/d11600.pdf.

[18] Stephanie Condon, "Obama: 'No Such Thing as Shovel-Ready Projects'," *CBSNews.com*, October 13, 2010, http://www.cbsnews.com/8301-503544_162-20019468-503544.html. For further information, see Bruce Bartlett, "How Not to Stimulate the Economy," *The Public Interest* 112 (Summer 1993): 99–109 and Olivier Blanchard and Roberto Perotti, "An Empirical Characterization of the Dynamic Effects of Changes in Government Spending and Taxes on Output," *The Quarterly Journal of Economics* 117 (2002): 1329–68, http://ideas.repec.org/a/tpr/qjecon/v117y2002i4p1329-1368.html.

- The spending wasn't targeted. Stimulus funds have not been allocated according to a state's level of economic distress. There is no statistical correlation between all relevant unemployment indicators and the allocation of funds. Also, no correlation between other economic indicators, such as income and stimulus funding exists.[19]

- The spending wasn't temporary. Even in Keynesian models, stimulus is only effective as a short-term measure.[20] A review of historical stimulus efforts has shown that temporary stimulus spending tends to linger. Two years after an initial stimulus, 95 percent of the spending surge remains.[21] Data from 50 states over 13 years shows that "temporary" grants from the federal government to state and local governments cause the latter to increase their own future taxes by between 33 cents and 42 cents for every dollar in federal grants states received.[22]

The evidence from ARRA strongly suggests that— even by Keynesian standards—more government spending won't provide much, if any, stimulus.

RECENT MERCATUS RESEARCH ON STIMULUS

Garett Jones and Daniel M. Rothschild, "Did Stimulus Dollars Hire the Unemployed?" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2011).
Garett Jones and Daniel M. Rothschild, "No Such Thing as Shovel Ready: The Supply Side of the Recovery Act" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2011).

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[19] Garett Jones and Daniel M. Rothschild, "Did Stimulus Dollars Hire the Unemployed?" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2011), http://mercatus.org/sites/default/files/publication/Did_Stimulus_Dollars_Hire_The_Unemployed_Jones_Rothschild_WP34.pdf.

[20] This is because government does not create the resources that it dispenses during a stimulus; it removes them from the private sector by borrowing them. And only in the short run—before prices can adjust—do Keynesian models predict that it is possible for government to redeploy these borrowed resources more effectively than the private sector would have. Once prices (including the price of labor and the price of capital) adjust, further stimulus inexorably crowds out private activity.

[21] Blanchard and Perotti.

[22] Russell Sobel and George Crowley, "Do Intergovernmental Grants Create Ratchets in State and Local Taxes?" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2010), http://mercatus.org/sites/default/files/publication/Do%20Intergovernmental%20Grants%20Create%20Ratchets.WP_.Corrected.10.4.10_0.pdf.