



Legacy of the Stimulus

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Last week, President Obama celebrated the one-year anniversary of the signing of the stimulus bill with a ceremony in the Executive Office Building. He acknowledged that implementation of the stimulus had not been “perfect” but took particular pride in the efficiency of the stimulus spending given “the scope, the magnitude of this thing.” But its scope and magnitude is precisely what led more responsible analysts to counsel against its enactment. Former Council of Economic Advisers Chair Ed Lazear dubbed it the “Brewster’s Millions” problem: even if one accepts that deficit spending can provide a boost to the economy, the very real administrative challenges associated with getting that money out the door in a timely manner make a spending stimulus an unattractive option. After one year, the stimulus has failed to stem the tide of rising unemployment, but has succeeded in dramatically complicating the near-to-medium term fiscal situation.

The case for stimulus is typically based on the “output gap” – the difference between the economy’s current and potential growth rate. Stimulus spending is supposed to “fill in” that gap until the private sector rebounds and growth returns to trend. But by the time economic growth turned positive in the third quarter of 2009, only \$29 billion of the \$280 billion of the stimulus funds allocated to state and local governments had been distributed to states. At the end of 2009, less than 20% (p. 33) of the authorized infrastructure dollars had been spent. By the start of the fourth quarter – when actual growth reached 5.7% or nearly 3% more than long-term trend growth – less than one-fourth of the \$862 billion stimulus had made it out the door. And this does not account

for whatever delays occurred at the state and local level.

The inefficiency of stimulus is perhaps best captured by the fact that bill will increase federal government spending by \$289 billion between 2011 and 2019 (Table A-1, total outlays). This increase in outlays is almost 50% larger than the bill’s total impact in fiscal year 2009. Perhaps the stimulus bill was dubbed the “Recovery Act” because so much of its spending

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Whatever good has been done by the money that did find its way into the economy, it has been partially offset by the impact deficit spending has had on the decision-making of businesses leaders, households, investors, and creditors – who are all wondering who’s going to pay for all of this. The Administration has layered policy uncertainty on top of economic uncertainty in a way that has paralyzed economic decision-making.

In the four quarters ending in September, companies in the S&P 500 added \$1.29 trillion to their cash reserves instead of hiring workers or making new investments. According to the Federal Reserve (L.100 and L.101), households, nonfinancial



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corporations, and unincorporated businesses hold more than \$10 trillion in cash and cash equivalents – deposits at banks and money market mutual funds. Although cash hoarding has abated somewhat as the financial system stabilized, total cash holdings are still 20% higher as a share of household financial assets (which are much diminished) than at the start of the recession. When viewed in conjunction with the uncertainties created by carbon caps and regulatory reform, it is not clear that the economic boost from enlarging the public sector has outweighed the costs of frightening the private sector that will ultimately be responsible for paying for it.