## \*\*\* Infrastructure Stimulus Fails

### Infrastructure Stimulus Fails

#### Infrastructure stimulus fails—multiple reasons.

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Four years into the deepest recession since World War II, the U.S. economy expanded at a rate of only 0.7 percent in the first half of 2011. This means that the economy is growing at a slower pace than the population and that capita output continues to fall.2

In response, the president has announced a plan for yet more deficit-financed stimulus spending.3 Like the two previous stimulus bills, this one focuses on infrastructure spending. The president‘s plan is rooted in the belief that stimulus spending and deeper deficits will give the economy the lift it needs to create more jobs. The hope is that, eventually, the economy will grow fast enough to allow the government to begin to pay down the national debt.

There are three problems with this approach. First, despite the claims of stimulus proponents, the evidence is not at all clear that more stimulus would be helpful right now. Second, even if one adheres to the idea that more government spending can jolt the economy, spending—particularly infrastructure spending—cannot be implemented in the way Keynesians say it ought to be. This greatly undermines its stimulative effect. Third, while no one disputes the value of good infrastructure, this type of spending typically suffers from massive cost overruns, waste, fraud, and abuse. This makes it a particularly bad vehicle for stimulus. In sum, further stimulus would be a risky short-term gamble with near-certain negative consequences in the long term.

#### Their evidence assumes optimal distribution—that’s impossible.

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Perhaps the most important reasons to be skeptical about further stimulus—particularly infrastructure stimulus—have to do with the way it is implemented. As a general rule, the studies that obtain large multipliers do so by assuming that stimulus funds will be distributed just as Keynesian theory says they ought to be. Keynesian economist and former presidential economic advisor Lawrence Summers has offered a widely accepted summary of how—ideally—fiscal stimulus ought to be applied.18 He argues that fiscal stimulus “can be counterproductive if it is not timely, targeted, and temporary.” In reality, however, infrastructure spending cannot fulfill these criteria.

#### We’ll isolate several reasons—

#### A. Delays.

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The problems with infrastructure stimulus: There are unique problems with infrastructure stimulus that tend to diminish its chances of success. Chief among these are long implementation delays. The Congressional Budget Office reports that:

[F]or major infrastructure projects supported by the federal government, such as highway construction and activities of the Army Corps of Engineers, initial outlays usually total less than 25 percent of the funding provided in a given year. For large projects, the initial rate of spending can be significantly lower than 25 percent.17

Economists from the IMF studied the impact of implementation delays on the multiplier and found that, “Implementation delays can postpone the intended economic stimulus and may even worsen the downturn in the short run.”

#### B. Can’t effectively target.

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Un-targeted: Effective targeting means that stimulus money should be spent in those areas that have been hardest hit by the recession. The goal is to make the most use of “idle resources” (as Keynesian theory terms them). For instance, depressed areas like Detroit have a considerable number of unemployed resources (people, firms, equipment, etc.). So theoretically, government stimulus should be able to put these idle resources to work. A number of studies, however, have shown that stimulus funding tends not to go to those areas that have been hardest hit by a recession.21

 Even targeted stimulus may fail: Many of the areas that were hardest hit by the recession are in decline because they have been producing goods and services that are not, and will never be, in great demand. Therefore, the overall value added by improving the roads and other infrastructure in these areas is likely to be lower than if the new infrastructure were located in growing areas that might have relatively low unemployment but do have great demand for more roads, schools, and other types of long-term infrastructure.22

#### C. Cost overruns.

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Cost overruns are the rule rather than the exception: The most comprehensive study of cost overruns examines 20 nations spanning five continents. The authors find that nine out of 10 public works projects come in over budget.30

Cost overruns dramatically increase infrastructure spending: Overruns routinely range from 50 to 100 percent of the original estimate.31 For rail, the average cost is 44.7 percent greater than the estimated cost at the time the decision is made. For bridges and tunnels, the equivalent figure is 33.8 percent, and for roads 20.4 percent.32 On average, U.S. cost-overruns reached $55 billion per year.33 Even if they lead to localized job growth, these investments are usually inefficient uses of public resources.

#### Prefer our evidence: their authors fall victim to planning fallacy and optimism bias.

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Survival of the un-fittest: Studies have shown that project promoters routinely ignore, hide, or otherwise leave out important project costs and risks to make total costs appear lower.37 Researchers refer to this as the “planning fallacy” or the “optimism bias.” Scholars have also found that it can be politically rewarding to lie about the costs and benefits of a project. The data show that the political process is more likely to give funding to managers who underestimate the costs and overestimate the benefits. In other words, it is not the best projects that get implemented but the ones that look the best on paper.38

### A2: Highest Multiplier Effect

#### No agreement about multiplier effect—they’re cherry-picking studies.

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No one disputes that American public works need improving, and economists have long recognized the value of infrastructure. Roads, bridges, airports, and canals are the conduits through which goods are exchanged. However, whatever its merits, infrastructure spending is unlikely to provide much of a stimulus — and it certainly won’t provide the boost that the president will promise the American people tonight.

For one thing, even though Mark Zandi claims that the bang for the buck is significant when the government spends $1 on infrastructure ($1.44 in growth), that’s just his opinion. The reality is that economists are far from having reached a consensus on what the actual return on infrastructure spending is. As economists Eric Leeper, Todd Walker, and Shu-Chum Yang put it in a recent paper for the IMF: “Economists have offered an embarrassingly wide range of estimated multipliers.” Among respected economists, some find larger multipliers and some find negative ones. (Thanks Matt Mitchell for this great paper).

#### Consensus of independent studies is on our side.

Utt 8 — Ronald D. Utt, Herbert and Joyce Morgan Senior Research Fellow in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation, holds a Ph.D. in Economics from the University of Indiana, 2008 (“More Transportation Spending: False Promises of Prosperity and Job Creation,” Heritage Foundation Backgrounder #2121, April 2nd, Available Online at http://www.heritage.org/research/reports/2008/04/more-transportation-spending-false-promises-of-prosperity-and-job-creation, Accessed 06-13-2012)

With the economy slowing and flirting with recession, many Members of Congress and several presidential candidates have been advocating a second, costly stimulus package that would rely more on government spending than on stimulating private spending with tax cuts. In many of these proposals, a portion of the new spending would go to infrastructure, with some or all of it targeted to transportation projects. As is often the case, many of the leading tax users in the field of transportation-the American Association of State Highway and Transportation Officials (AASHTO), the American Road and Transportation Builders (ARTBA), the American Public Transportation Association (APTA), and the Associated General Contractors-have urged Congress to spend more money on projects that would directly benefit their members.

As this paper demonstrates, most of the alleged economic benefits are based on grossly exaggerated claims made by a U.S. Department of Transportation (USDOT) computer simulation conducted in 2000 and 2002. In fact, the vast majority of independent academic and federal government studies on the relationship between infrastructure spending and economic activity have found that the impact is very modest and long in coming.

### A2: Infrastructure Is “Shovel Ready”

#### No such thing as “shovel-ready”.

De Rugy and Mitchell 11 — Veronique de Rugy, Senior Research Fellow at the Mercatus Center at George Mason University, former resident fellow at the American Enterprise Institute, policy analyst at the Cato Institute, and research fellow at the Atlas Economic Research Foundation, holds an M.A. in Economics from the University of Paris IX-Dauphine and a Ph.D. in Economics from the University of Paris Pantheon-Sorbonne, and Matthew Mitchell, Senior Research Fellow at the Mercatus Center at George Mason University, holds an M.A. and Ph.D. in Economics from George Mason University, 2011 (“Would More Infrastructure Spending Stimulate the Economy?,” Mercatus Center Working Paper Number 11-36, September, Available Online at http://mercatus.org/sites/default/files/publication/infrastructure\_deRugy\_WP\_9-12-11.pdf, Accessed 06-12-2012, p. 4-5)

There is no such thing as a “shovel ready” project: By nature, infrastructure spending fails to be timely. Even when the money is available, it can be months, if not years, before it is spent. This is because infrastructure projects involve planning, bidding, contracting, construction, and evaluation.19 [end page 4] According to the GAO, as of June 2011, 95 percent of the $45 billion in Department of Transportation infrastructure money had been appropriated, but only 62 percent ($28 billion) had actually been spent.20

#### Speeding up the process fails.

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A rapid increase in stimulus spending makes things worse: There is an inherent tradeoff between speed and efficiency. Policy makers need time to weigh the merits of a project, structure requests for proposals, administer a fair bidding process, select the best firms, competently build the project, and impartially evaluate the results. Quite understandably, economists have found that when funds are spent quickly, they are not spent wisely.39 In October 2010, President Obama conceded that, in fact, “There‘s no such thing as shovel-ready projects.”40

### A2: Spending Is Temporary

#### Spending isn’t temporary—it ratchets up.

De Rugy and Mitchell 11 — Veronique de Rugy, Senior Research Fellow at the Mercatus Center at George Mason University, former resident fellow at the American Enterprise Institute, policy analyst at the Cato Institute, and research fellow at the Atlas Economic Research Foundation, holds an M.A. in Economics from the University of Paris IX-Dauphine and a Ph.D. in Economics from the University of Paris Pantheon-Sorbonne, and Matthew Mitchell, Senior Research Fellow at the Mercatus Center at George Mason University, holds an M.A. and Ph.D. in Economics from George Mason University, 2011 (“Would More Infrastructure Spending Stimulate the Economy?,” Mercatus Center Working Paper Number 11-36, September, Available Online at http://mercatus.org/sites/default/files/publication/infrastructure\_deRugy\_WP\_9-12-11.pdf, Accessed 06-12-2012, p. 5-6)

Not temporary: Even in Keynesian models, stimulus is only effective as a short-run measure. In fact, Keynesians also call for surpluses during an upswing.24 In reality, however, the political process prefers to implement the first Keynesian prescription (deficit-financed spending) but not the second (surpluses to [end page 5] pay off the debt).25 The inevitable result is a persistent deficit that, year-in, year-out, adds to the national debt.26 A review of historical stimulus efforts has shown that temporary stimulus spending tends to linger and that two years after an initial stimulus, 95 percent of the spending surge remains.27

 Ratchet-up effect: Evidence from World War II suggests that when spending spikes, as is the case during the current recession, it tends not to return to pre-spike levels.28 This “ratchet up” in spending is exacerbated when federal spending is channeled through state and local governments, as was the case in ARRA. Data from 50 states over a 13-year period show that temporary grants from the federal government to state and local governments cause the latter to increase their own future taxes by between 33 and 42 cents for every dollar in federal grants received.29

### A2: Creates Jobs

#### No job creation—poaching.

De Rugy and Mitchell 11 — Veronique de Rugy, Senior Research Fellow at the Mercatus Center at George Mason University, former resident fellow at the American Enterprise Institute, policy analyst at the Cato Institute, and research fellow at the Atlas Economic Research Foundation, holds an M.A. in Economics from the University of Paris IX-Dauphine and a Ph.D. in Economics from the University of Paris Pantheon-Sorbonne, and Matthew Mitchell, Senior Research Fellow at the Mercatus Center at George Mason University, holds an M.A. and Ph.D. in Economics from George Mason University, 2011 (“Would More Infrastructure Spending Stimulate the Economy?,” Mercatus Center Working Paper Number 11-36, September, Available Online at http://mercatus.org/sites/default/files/publication/infrastructure\_deRugy\_WP\_9-12-11.pdf, Accessed 06-12-2012, p. 5)

 Job poaching, not creating: Unemployment rates among specialists, such as those with the skills to build roads or schools, are often relatively low. Moreover, it is unlikely that an employee specialized in residential-area construction can easily update his or her skills to include building highways. As a result, we can expect that firms receiving stimulus funds will hire their workers away from other construction sites where they were employed rather than from the unemployment lines. This is what economists call “crowding out.” Except that in this case, labor, not capital, is being crowded out. In fact, new data confirm that a plurality of workers hired with ARRA money were poached from other organizations rather than from the unemployment lines.23

## \*\*\* Keynesian Economics Bad

### Keynesian Theory of Stimulus Is Wrong

#### Keynesian theory is wrong—government spending can’t generate wealth.

Mitchell 9 — Daniel J. Mitchell, Senior Fellow at the Cato Institute, holds a B.A. and M.A. in Economics from the University of Georgia and a Ph.D. in Economics from George Mason University, 2009 (“Spending Is Not Stimulus: Bigger Government Did Not Work for Bush, and It Will Not Work for Obama,” *Tax & Budget Bulletin*, Number 5, February, Available Online at http://www.cato.org/pubs/tbb/tbb\_0209-53.pdf, Accessed 01-27-2010)

During the 1930s, Keynes and his disciples argued that the economy could be boosted if the government borrowed money and spent it. According to the theory, this new spending would put money in people’s pockets, and the recipients of the funds would then spend the money and “prime the pump” as the money began circulating through the economy. The Keynesians also said that some tax cuts—particularly lump-sum rebates—could have the same impact since the purpose is to have the government borrow and somehow put the money in the hands of people who will spend it.

Keynesian theory suffers from a rather glaring logical fallacy. It overlooks the fact that, in the real world, government can’t inject money into the economy without first taking money out of the economy. Any money that the government puts in the economy’s right pocket is money that is first removed from the economy’s left pocket. There is no increase in what Keynesians refer to as aggregate demand since every dollar that is spent on a stimulus package is a dollar that the government first must borrow from private credit markets. Keynesianism doesn’t boost national income, it merely redistributes it.

#### All of their evidence relies on the same Keynesian assumptions—if we win that Keynesianism is wrong, we beat this advantage.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

The Keynesian argument also assumes that consumption spending adds to immediate economic growth while savings do not. By this reasoning, unemployment benefits, food stamps, and low-income tax rebates are among the most effective stimulus policies because of their likelihood to be consumed rather than saved.

Taking this analysis to its logical extreme, Mark Zandi of Economy.com has boiled down the government's influence on America's broad and diverse $14 trillion economy into a simple menu of stimulus policy options, whereby Congress can decide how much economic growth it wants and then pull the appropriate levers. Zandi asserts that for each dollar of new government spending: temporary food stamps adds $1.73 to the economy, extended unemployment benefits adds $1.63, increased infrastructure spending adds $1.59, and aid to state and local governments adds $1.38.[4] Jointly, these figures imply that, in a recession, a typical dollar in new deficit spending expands the economy by roughly $1.50. Over the past 40 years, this idea of government spending as stimulus has fallen out of favor among many economists. As this paper shows, it is contradicted both by empirical data and economic logic.

#### Every dollar spent must come from *somewhere else*—there is no *net* creation of wealth.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Moving forward, the important question is why government spending fails to end recessions. Spending-stimulus advocates claim that Congress can "inject" new money into the economy, increasing demand and therefore production. This raises the obvious question: 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.[7]

Congress cannot create new purchasing power out of thin air. If it funds new spending with taxes, it is simply redistributing existing purchasing power (while decreasing incentives to produce income and output). If Congress instead borrows the money from domestic investors, those investors will have that much less to invest or to spend in the private economy. If they borrow the money from foreigners, the balance of payments will adjust by equally raising net imports, leaving total demand and output unchanged. Every dollar Congress spends must first come from somewhere else.

#### This alone beats their advantage.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Removing water from one end of a swimming pool and pouring it in the other end will not raise the overall water level. Similarly, taking dollars from one part of the economy and distributing it to another part of the economy will not expand the economy.

### Economy Will Recover Without Stimulus

#### The economy will recover without government spending—stimulus efforts have empirically failed.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

All recessions eventually end. The U.S. economy has proved resilient enough to eventually overcome even the most misguided economic policies of the past. Yet it would be fallacious to credit the stimulus bill for any economic recovery that inevitably occurs in the future. According to Keynesian theory, a $1.4 trillion budget deficit should have immediately overheated the economy. According to the White House, the stimulus should have created 3.3 million net jobs. Instead, the economy remained in recession and 3.5 million more net jobs were lost. By every reasonable standard, the stimulus failed.

H. L. Mencken once wrote that "complex problems have simple, easy to understand, wrong answers." He may as well have been referring to the idea that Congress can foster economic growth simply by "injecting" money into the economy. Government stimulus spending is not a magic wand that creates jobs and income. Repeated failed attempts in America and abroad have shown that governments cannot spend their way out of recessions. Focusing on productivity growth builds a stronger economy over the long term—and leaves America better prepared to handle future economic downturns.

#### The economy is resilient absent more stimulus.

Scissors and Foster 11 — Derek Scissors, Research Fellow in Asia Economic Policy in the Asian Studies Center, Adjunct Professor at George Washington University, holds an M.A. in Economics from the University of Chicago and a Ph.D. in International Political Economy from Stanford University, and J. D. Foster, Norman B. Ture Senior Fellow in the Economics of Fiscal Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation, holds a Ph.D. in Economics from Georgetown University, 2011 (“Avoiding America’s Lost Decades,” Heritage Foundation WebMemo #3398, October 18th, Available Online at http://www.heritage.org/Research/Reports/2011/10/Avoiding-Americas-Lost-Decades, Accessed 11-07-2011)

Though much damage has already been done, the American economy is still fundamentally flexible and resilient. What is needed is to jettison the convenient fantasy that deficit spending stimulates the economy and instead adopt a more benign attitude that, for the sake of recovery, Washington should “first, do less harm,” which means:

\* The federal government should rein in spending to restore a degree of confidence in America’s future,

\* The President should stop threatening higher taxes, and

\* The Administration should end the regulatory attack on America’s businesses.

The U.S. is still well-positioned to turn its economy around and avoid Japan’s fate. If Washington would just do less harm—and if the Japanese government would just do less harm in Japan—each country would enjoy a more prosperous future.

#### That means the status quo is the best option—government action can only *harm* the recovery.

Foster 11 —J. D. Foster, Norman B. Ture Senior Fellow in the Economics of Fiscal Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation, holds a Ph.D. in Economics from Georgetown University, 2011 (“Promoting Job Creation and Reducing Unemployment in the U.S.,” Congressional Testimony, September 21st, Available Online at http://www.heritage.org/Research/Testimony/2011/09/Promoting-Job-Creation-in-the-US, Accessed 11-07-2011)

The federal government should adopt a very simple guiding principle for deciding what to do next. That principle is to do less harm. There is very little in terms of concrete actions government can do at this stage that would help, and a great deal of intended help that would harm, either by raising the deficit to no good effect or by creating more uncertainty and slowing the economy’s natural healing process.

Do less harm means getting spending under control and thereby cutting the budget deficit. Americans are worried about spending and the deficit. That worry by itself is holding us back.

Do less harm means policymakers should stop threatening higher taxes. We can have debates about who should pay what when we’re at full employment. In the meantime, this threat is debilitating.

Do less harm means stop the onslaught of new regulations. The recent pullback of the EPA’s ozone regulation was a good example. Even the threat of new regulations creates bad uncertainty for those affected, freezing them in place. Again, we can work through these regulations when Americans are back to work.

Do less harm means policymakers should stop meddling with the economy. There is almost no limit to the harm Washington can do to the economy in its efforts to do something for the economy. The patient is in recovery, slowed by the incessant proddings and procedures of Washington’s policy doctors. The patient doesn’t need another procedure or a new nostrum. Let it heal. Do less harm.

### Spending Empirically Fails — General

#### History is on our side—government stimulus empirically fails.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Indeed, President Obama's stimulus bill failed by its own standards. In a January 2009 report, White House economists predicted that the stimulus bill would create (not merely save) 3.3 million net jobs by 2010. Since then, 3.5 million more net jobs have been lost, pushing the unemployment rate above 10 percent.[1] The fact that government failed to spend its way to prosperity is not an isolated incident:

• 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 (building the largest national debt in the industrialized world)—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.

• Now, the most recent $787 billion stimulus bill was intended to keep the unemployment rate from exceeding 8 percent. In November, it topped 10 percent.[2]

Undeterred by these repeated stimulus failures, President Obama is calling for yet another stimulus bill.[3] There is every reason to expect another round to fail as miserably as the past ones, and it would bury the nation deeper in debt.

#### The historical record is one-sided: stimulus always fails.

Rahn 8 — Richard W. Rahn, Senior Fellow at the Cato Institute and Chairman of the Institute for Global Economic Growth, holds a B.A. in Economics at the University of South Florida, an M.B.A. from Florida State University, and a Ph.D. from Columbia University, 2008 (“What Is Economic Stimulus?,” *The Washington Times*, December 3rd, Available Online at http://www.cato.org/pub\_display.php?pub\_id=9816, Accessed 01-27-2010)

Every time direct government payments have been tried, they have failed. During the Great Depression, government spending soared as a percentage of gross domestic product, but full employment did not return until World War II. During the last eight years, U.S. government spending has greatly increased in both absolute terms and as a percentage of GDP, yet the economy now performs worse than it did a decade ago.

#### Here’s evidence about specific examples:

#### A. Hoover and Roosevelt.

Mitchell 9 — Daniel J. Mitchell, Senior Fellow at the Cato Institute, holds a B.A. and M.A. in Economics from the University of Georgia and a Ph.D. in Economics from George Mason University, 2009 (“Spending Is Not Stimulus: Bigger Government Did Not Work for Bush, and It Will Not Work for Obama,” *Tax & Budget Bulletin*, Number 5, February, Available Online at http://www.cato.org/pubs/tbb/tbb\_0209-53.pdf, Accessed 01-27-2010)

Real-world evidence does not support the Keynesianism perspective. In his four years, Herbert Hoover increased taxes dramatically, including a boost in the top tax rate from 25 percent to 63 percent. He imposed harsh protectionist policies. He significantly increased intervention in private markets. Most importantly, at least from a Keynesian perspective, he boosted government spending by 47 percent in just four years. And he certainly had no problem financing that spending with debt. He entered office in 1929, when there was a surplus, and he left office in 1933 with a deficit of 4.5 percent of GDP. 3

Unfortunately, other than being a bit more reasonable on trade, Roosevelt followed the same approach. The top tax was boosted to 79 percent and government intervention became more pervasive. Government spending, of course, skyrocketed—rising by 106 percent between 1933 and 1940. This big-government approach didn’t work for Roosevelt any better than it did for Hoover. Unemployment remained very high, averaging more than 17 percent throughout the 1930s, and overall output did not get back to the 1929 level until World War II. According to recent research by economists at UCLA, New Deal policies extended the Depression by seven years. 4

#### B. Ford and Bush.

Mitchell 9 — Daniel J. Mitchell, Senior Fellow at the Cato Institute, holds a B.A. and M.A. in Economics from the University of Georgia and a Ph.D. in Economics from George Mason University, 2009 (“Spending Is Not Stimulus: Bigger Government Did Not Work for Bush, and It Will Not Work for Obama,” *Tax & Budget Bulletin*, Number 5, February, Available Online at http://www.cato.org/pubs/tbb/tbb\_0209-53.pdf, Accessed 01-27-2010)

Other Keynesian episodes generated similarly dismal results, though fortunately never as bad as the Great Depression. Gerald Ford did a Keynesian stimulus focused on tax rebates in the mid-1970s. The economy did not improve. But why would it? After all, borrowing money from one group and redistributing it to another does nothing to increase economic output. As mentioned above, George W. Bush gave out so-called rebate checks in 2001 and 2008, yet there was no positive effect either time. And he certainly was a big spender, yet that didn’t work either.

#### C. Japan.

Mitchell 9 — Daniel J. Mitchell, Senior Fellow at the Cato Institute, holds a B.A. and M.A. in Economics from the University of Georgia and a Ph.D. in Economics from George Mason University, 2009 (“Spending Is Not Stimulus: Bigger Government Did Not Work for Bush, and It Will Not Work for Obama,” *Tax & Budget Bulletin*, Number 5, February, Available Online at http://www.cato.org/pubs/tbb/tbb\_0209-53.pdf, Accessed 01-27-2010)

International evidence also undermines the case for Keynesianism. The clearest example may be Japan, which throughout the 1990s tried to use so-called stimulus packages in an effort to jump-start a stagnant economy. But the only thing that went up was Japan’s national debt, which more than doubled during the decade and is now even far more than Italy’s when measured as a share of GDP. The Japanese economy never recovered, and the 1990s are now known as the “lost decade” in Japan.

### Spending Empirically Fails — Obama

#### Recent stimulus has failed—this answers their “would have been worse without” *and* “it was too small” warrants.

Taylor 11 — John B. Taylor, Mary and Robert Raymond Professor of Economics at Stanford University, 2011 (“An Empirical Analysis of the Revival of Fiscal Activism in the 2000s,” *Journal of Economic Literature*, Volume 49, Number 3, Available Online at http://www.stanford.edu/~johntayl/JEL\_Taylor\_Final%20Pages.pdf, Accessed 06-12-2012, p. 701)

In sum, this empirical examination of the direct effects of the three countercyclical stimulus packages of the 2000s indicates that they did not have a positive effect on consumption and government purchases, and thus did not counter the decline in investment during the recessions as the basic Keynesian textbook model would suggest. Individuals and families largely saved the transfers and tax rebates. The federal government increased purchases, but by only an immaterial amount. State and local governments used the stimulus grants to reduce their net borrowing (largely by acquiring more financial assets) rather than to increase expenditures, and they shifted expenditures away from purchases toward transfers.

Some argue that the economy would have been worse off without these stimulus packages, but the results do not support that view. According to the empirical estimates of the impact of ARRA, if there had been no temporary stimulus payments to individuals or families, their total consumption would have been about the same. And if there had been no ARRA grants to states and localities, their total expenditures would have been about the same. The counterfactual simulations show that the ARRA-induced decline in state and local government purchases was larger than the increase in federal government purchases due to ARRA. In terms of the simple example of model A versus model B presented above, these results are evidence against the views represented by model A, and thus against using such models to show that things would have been worse.

Others argue that the stimulus was too small, but the results do not lend support to that view either. Using the estimated equations, a counterfactual simulation of a larger stimulus package—with the proportions going to state and local grants, federal purchases, and transfers to individuals the same as in ARRA—would show little change in government purchases or consumption, as the temporary funds would be largely saved. Of course, the story would be different for a stimulus program designed more effectively to increase purchases, but it is not clear that such a program would be politically or operationally feasible.

More generally, the results from the 2000s experience raise considerable doubts about the efficacy of temporary discretionary countercyclical fiscal policy in practice. In this regard, the experience with the stimulus packages of the 2000s adds more weight to the position reached more than thirty years ago by Lucas and Sargent (1978) and Gramlich (1978, 1979).

#### Prefer our evidence—Taylor independently studied the data instead of relying on models.

Feasel 11 — Kevin Feasel, holds an M.A. in Economics and Politics from Albert-Ludwigs-Universität in Germany, 2011 (“In The Papers: The Repeated Failure Of Keynesianism,” *36 Chambers*—a blog, July 15th, Available Online at http://36chambers.wordpress.com/2011/07/15/in-the-papers-the-repeated-failure-of-keynesianism/, Accessed 06-13-2012)

John Taylor has a new paper out, entitled An Empirical Analysis of the Revival of Fiscal Activism in the 2000s.

Abstract: Macroeconomic data indicate that the three American discretionary countercyclical stimulus packages of the 2000s had little if any direct impact on consumption or government purchases, and thus did not stimulate the economy as Keynesian models would predict. Households largely saved the transfers and tax rebates. The federal government only increased purchases by a very small amount. State and local governments saved their stimulus grants and shifted expenditures from purchases toward transfers. Counterfactual simulations of the 2009-10 period show that a stimulus-induced decline in state and local government purchases was larger than the increase at the federal level. Counterfactual simulations also show that a larger stimulus package—with the proportions going grants, federal purchases, and net transfers to households as in 2009-10— would not have increased government purchases or consumption by a larger amount. These results from the 2000’s experience raise doubts about the efficacy of such packages adding weight to similar assessments reached more than 30 years ago.

Very basic Keynesian theory holds that a drop in investment can be countered by an increase in government spending, temporary tax refunds, or handouts (2). They use this theory to create models, showing that an increase in government spending by $X will decrease unemployment by y%. The most famous of these is the oft-derided ARRA unemployment chart published by Christina Romer. When dealing with tracking your projections, Taylor argues that you cannot use the model to verify whether the model worked: the model will just spit out the same thing over and over (2). So if you use the ARRA unemployment reduction model, plug in the actual numbers, and look at the results, you’ll say, “Boy, it’s a good thing we had ARRA, because we would have been really beaten up otherwise!” Unfortunately, this does not follow: all you’re doing is using the model to verify the model. Instead, you need to use a different technique: actually study the data rather than plugging it into the model.

Taylor focuses on three Keynesian stimulus periods: the tax rebates of 2001 and 2008, and ARRA (5-6). He notes that the 2008 and 2009 “stimuli” fail to increase personal consumption (7) and the temporary stimulus impact is not statistically different from 0 (8). In other words, these Keynesian stimuli failed. Even better, ARRA failed to operate how it was supposed to: the change in federal purchases as a percentage of GDP, or even as a percentage of total ARRA spending, was tiny (12), meaning that these small changes wouldn’t “turn around the economy.” State and local money was supposed to be used for infrastructure (you know—those “shovel-ready” jobs that we’re supposed to joke about now) and the purchase of other goods and services. Instead, Taylor notes that state spending leveled off from 2009-2011, meaning that states replaced net borrowing with temporary ARRA funds for that time period (12-13). So the crowding-out effect was almost 100% for those funds.

#### The 2009 stimulus disproves Keynesian theories.

#### A. Massive spending didn’t stimulate the economy.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Economic data contradict Keynesian stimulus theory. If deficits represented "new dollars" in the economy, the record $1.2 trillion in FY 2009 deficit spending that began in October 2008--well before the stimulus added $200 billion more[5]--would have already overheated the economy. Yet despite the historic 7 percent increase in GDP deficit spending over the previous year, the economy shrank by 2.3 percent in FY 2009.[6] To argue that deficits represent new money injected into the economy is to argue that the economy would have contracted by 9.3 percent without this "infusion" of added deficit spending (or even more, given the Keynesian multiplier effect that was supposed to further boost the impact). That is simply not plausible, and few if any economists have claimed otherwise.

#### B. This proves Keynesian economic models are wrong.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

This is no longer a theoretical exercise. The idea that increased deficit spending can cure recessions has been tested repeatedly, and it has failed repeatedly. The economic models that assert that every $1 of deficit spending grows the economy by $1.50 cannot explain why $1.4 trillion in deficit spending did not create a $2.1 trillion explosion of new economic activity.

### A2: CBO Report Proves Stimulus Worked

#### The CBO report begs the question—Keynesian models can’t prove Keynesianism correct.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“The Fatal Flaw of Keynesian Stimulus,” *The Washington Times*, August 31st, Available Online at http://www.heritage.org/Research/Commentary/2010/08/The-Fatal-Flaw-of-Keynesian-Stimulus, Accessed 11-07-2011)

Last week, the Congressional Budget Office released a report claiming that the $814 billion "stimulus" has added 3.4 million net jobs. This surely comes as a surprise to the 3.5 million Americans who have lost their jobs and remained unemployed since the stimulus was enacted in February 2009.

Such implausible analysis does not come from actually observing the post-stimulus economy. Rather, it comes from Keynesian economic models that have been programmed to conclude that government spending injects new dollars into the economy, thereby increasing demand and spurring economic growth. In other words, these models are programmed to conclude that stimulus spending always creates jobs and growth, no matter how the economy actually performs.

#### This makes their evidence totally worthless.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Stimulus Jobs Count: CBO Admits It Ignored the Economy’s Actual Performance,” Heritage Foundation WebMemo #2843, March 23rd, Available Online at http://www.heritage.org/Research/Reports/2010/03/Stimulus-Jobs-Count-CBO-Admits-It-Ignored-the-Economys-Actual-Performance, Accessed 11-07-2011)

The "Begging the Question" Fallacy

The CBO's conclusion that the stimulus created jobs is based on an economic model that began with the premise that all stimulus bills create jobs. In other words, the conclusion is already assumed as a premise. Logicians call this the fallacy of begging the question. Mathematicians call it assuming what you are trying to prove.

More specifically, the CBO's model started by automatically assuming that government spending increases GDP by pre-set multipliers, such as:

\* Every $1 of government spending that directly purchases goods and services ultimately raises the GDP by $1.75;

\* Every $1 of government spending sent to state and local governments for infrastructure ultimately raises GDP by $1.75;

\* Every $1 of government spending sent to state and local governments for non-infrastructure spending ultimately raises GDP by $1.25; and

\* Every $1 of government spending sent to an individual as a transfer payment ultimately raises GDP by $1.45.[3]

(Note that all CBO figures in this paper represent the midpoint between their high and low estimates.)

Then the CBO plugged the stimulus provisions into the multipliers above, came up with a total increase in GDP of 2.6 percent, and then converted that additional GDP into 1.5 million jobs.

The problem here is obvious. Once the CBO decided to assume that every dollar of government spending increased GDP by the multipliers above, its conclusion that the stimulus saved jobs was pre-ordained. The economy could have lost 30 million jobs, and the model would have said that the economy would otherwise have lost 31.5 million jobs without the stimulus. An asteroid could have hit the United States, wiping out everyone outside of Washington, D.C., and (as long as Washington still spent the stimulus money) the CBO's economic model would have produced the same stimulus jobs data. There is no adjustment made to reflect what actually happened in the economy after the stimulus was enacted.

#### The CBO admits they didn’t actually examine the post-stimulus economy—it just re-released its old forecast.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Stimulus Jobs Count: CBO Admits It Ignored the Economy’s Actual Performance,” Heritage Foundation WebMemo #2843, March 23rd, Available Online at http://www.heritage.org/Research/Reports/2010/03/Stimulus-Jobs-Count-CBO-Admits-It-Ignored-the-Economys-Actual-Performance, Accessed 11-07-2011)

If a meteorologist was asked what the day's high temperature had been, would it be acceptable to simply repeat his/her earlier forecast? Of course not. The forecast was merely a prediction, which should now be replaced with what actually happened.

Yet that is the approach the Congressional Budget Office (CBO) used when declaring that the stimulus had saved 1.5 million jobs. Rather than actually examine the performance of the post-stimulus economy, it essentially re-released its old forecast that the stimulus would likely create jobs.

CBO Confirms Its Methodology

In a recent speech to the National Association of Business Economics, CBO Director Doug Elmendorf confirmed this by stating:

[W]e don't think one can learn much from watching the evolution of particular components of GDP [gross domestic product] over the last few quarters about the effects of the stimulus … so we fall back on repeating the sort of analysis we did before. And we tried to be very explicit about it that it is essentially repeating the same exercise we did rather than an independent check on it.[1]

When asked if this means that any actual underperformance of the stimulus would fail to show up in the CBO's stimulus jobs count, Elmendorf replied "That's right." This means the 1.5 million jobs saved estimate was pre-determined.

Of course, the stimulus was originally promised to create (not just save) more than 3 million jobs.[2] Instead, the economy has since lost more than 3 million additional net jobs. The abject failure of the stimulus policies recommended by Keynesian economic models should induce some fundamental re-analysis of these models' assumptions. Instead, the CBO is re-releasing the same jobs analysis—with the same economic assumptions—that they had used a year ago.

### A2: Short-Term Benefits

#### Even if there are short-term benefits, they are small and overwhelmed by long-term costs.

Hassett 11 — Kevin Hassett, Senior Fellow and Director of Economic Policy Studies at the American Enterprise Institute, former served as a senior economist at the Board of Governors of the Federal Reserve System and an associate professor of economics and finance at the Graduate School of Business of Columbia University, holds a Ph.D. in Economics from the University of Pennsylvania, 2011 (“Stimulus Optimists vs. Economic Reality,” *Wall Street Journal*, July 15th, Available Online at http://online.wsj.com/article/SB10001424053111903520204576484071534800318.html, Accessed 06-13-2012)

With the economy once again teetering on the edge of recession, policy makers will inevitably propose another round of stimulus spending. You can bet on it—just as you can bet that any such spending won't help the economy. From the beginning, the Obama administration has misdiagnosed the problem and implemented policies that are indefensible.

Consider the problem of economic stabilization. In the old days, U.S. recessions were short and recoveries sharp: Between World War II and 1990, the average rate of growth in gross domestic product (GDP) in the five quarters after a recession was 6.8%.

For the stimulus optimist, the temptation of moving some of that blockbuster growth into the recession is certainly overwhelming. But getting the timing right is a daunting—or even impossible—task.

It's hard enough to call the onset of the recession correctly and arrange the spending so that it happens at precisely the right moment. But the successful policy maker must also remove the stimulus at a moment of unusually high growth. If not, the drag from disappearing stimulus could easily push the economy back into recession.

Keynesians tend to assume that government spending has a big positive effect on economic growth. Others disagree. But if the impact of increasing government spending is large, then the impact of removing it is also. So policy makers better be sure that the boom is around the corner.

And all these are just short-run considerations. Here's the real dirty secret of Keynesian policies: They are sure to have a negative effect in the fullness of time.

Every stimulus effort has not two but three stages. When the stimulus is imposed, there is some positive short-run increase in GDP. When the stimulus is removed, there is an approximately equal and opposite reduction in GDP. But after that, the stimulus must be paid for with higher taxes or ongoing borrowing—causing a further reduction in GDP. Thus the total impact of the Keynesian policy is negative over its life. This fact is visible even in the fine print of Congressional Budget Office analyses so often cited by stimulus apologists, such as its 2009 finding that the Obama stimulus would reduce output in the long run.

Obama administration officials should have known all this as they set out in 2009. Financial crises inevitably create lengthy periods of slow economic growth, as research by economists Carmen Reinhart and Kenneth Rogoff has shown. The typical duration of the employment downturn after a financial crisis is 4.8 years. Another study by Ms. Reinhart and her husband Vincent Reinhart found that economic growth rates tend to be lower for as much as a decade after financial crises.

Given this lengthy period of slow growth, it was a mistake for the Obama administration to pursue short-term Keynesian stimulus. Such a policy might be wise if the economy were in a typical recession, which can be expected to last a bit less than a year and be followed by a recovery with sharply higher growth. In such a case, adding a percent or two of growth during the recession might be worth having a slower recovery.

But in the lengthy, slow slog out of a financial crisis, the stimulus hangover arrives before the recovery has taken off. Temporary stimulus therefore hurts the economy when it is removed and again when it is paid for. The hangover is virtually guaranteed to arrive at a moment when it can push us back into recession.

Worse, aggressive stimulus sets off a kind of Keynesian death spiral in which nervous politicians adopt repeated stimulus packages in order to avert near-term distress, the cumulative effect of which can be ruinous.

#### Spending has a net-negative impact over the long-term—government spending hurts overall economic productivity.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Government spending can affect long-term economic growth, both up and down. Economic growth is based on the growth of labor productivity and labor supply, which can be affected by how governments directly and indirectly influence the use of an economy's resources. However, increasing the economy's productivity rate—which often requires the application of new technology and resources—can take many years or even decades to materialize. It is not short-term stimulus.[13]

In fact, large stimulus bills often reduce long-term productivity by transferring resources from the more productive private sector to the less productive government. The government rarely receives good value for the dollars it spends. However, stimulus bills provide politicians with the political justification to grant tax dollars to favored constituencies. By increasing the budget deficit, large stimulus bills eventually contribute to higher interest rates while dropping even more debt on future generations.

### A2: Private Savings Necessitate Government Spending

#### The thesis of their argument is wrong—savings don’t drop out of the economy.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Critics' Objection No. 1: People Are Saving Instead of Spending, and Banks Are Not Lending.By Borrowing and Spending these "Idle Savings," Government Can Circulate More Money Through the Economy. This is the most common defense of government stimulus cited by policymakers. Indeed, among proponents of government spending there is a strong focus on whether people are spending or saving, with the implication that spending circulates through the economy while savings effectively drop out.

But savings do not drop out of the economy. Nearly all people put their savings in: (1) banks, which quickly lend the money to others to spend; (2) investments in stocks and bonds; or (3) personal debt reduction. In each of these situations, the financial system transfers one person's savings to someone else who can spend it. So all money is quickly spent regardless of whether it was initially consumed or saved. The only savings that drop out of the economy are those hoarded in mattresses and safes.

#### If they can’t answer this argument, they lose the economy advantage.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Stimulus spending advocates must be able to show that nearly all money lent to Washington would have otherwise sat idle in mattresses and bank safes. Otherwise, Washington is merely a middleman transferring purchasing power from one part of the economy to another—and the justification for government spending as stimulus collapses.

#### Banks don’t sit on money—savings finance spending.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Some contend that recession-weary banks are hoarding savings well beyond the legal minimum reserves. Yet even when banks hesitate to lend their deposits, they invest them in Treasury bills to keep them circulating through the economy and earning interest.[14] In fact, the federal funds market--where banks lend each other any excess cash at the end of the day--exists because banks refuse to sit on unused cash even overnight. Thus, even in recessions, one person's savings quickly finances another person's spending.[15]

#### Even if their argument is true and money is being hoarded, it can’t be obtained by the government to fund new spending—their argument is nonsensical.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Advocates of the "idle savings" theory fail to specify the location of all these newly hoarded piles of dollar bills they believe have been shielded from spending in the financial system. Even more telling, they also fail to explain—even if there were massive amounts of idle savings—how the federal government is supposed to acquire them for injection as new spending. After all, even if individuals, businesses, and banks were hoarding dollar bills in mattresses and safes, why would they suddenly lend them to the government to finance a stimulus bill? The very idea of hoarding dollars suggests these people and businesses would not trust the financial system, and would be quite unlikely to attend the next Treasury bill auction.[16]

### A2: Foreign Borrowing Stimulates The Economy

#### Borrowing from foreign nations is at best net-neutral—it can’t stimulate the economy.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Critics' Objection No. 2: Borrowing from Foreign Nations Can Provide "New" Money for the Economy. Accepting that domestic borrowing is no free lunch, some analysts have asserted that foreign borrowing can inject new dollars into the economy. However, these nations must acquire American dollars before they can lend them back to Washington. Foreign countries can acquire American dollars by either:

\* Attracting American investments in their country. In that instance, the dollars leaving America match the dollars lent back to America. The net flow of saving circulating through the U.S. economy does not increase.

\* Selling goods and services to Americans and receiving American dollars in return. For the United States, these imports raise the trade deficit and thus reduce domestic demand. The government's subsequent borrowing back and spending of these dollars merely offsets the increased trade deficit.

In either situation, American dollars must first leave the country before they can be lent back into the U.S. economy. The balance of payments between America and other nations must net zero. Consequently, government spending funded from foreign borrowing does not provide stimulus.

### A2: Spending Has A Multiplier Effect

#### This is irrelevant to the question of whether government can stimulate the economy—their argument falls victim to the broken window fallacy.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Critics' Objection No. 3: Government Spending Has a Multiplier Effect That Allows the Money to Re-circulate Through the Economy Multiple Times. This point is correct but irrelevant to the question of stimulus. Yes, $100 in unemployment benefits can be spent at a grocery store, which, in turn, can use that $100 to pay salaries and support other jobs. The total amount of additional economic activity will be well above $100; but because government borrows the $100, that same money is now unavailable to the private sector—which would have spent the same $100 with the same multiplier effect.

Consider a more comprehensive example. A family might normally put its $10,000 savings in a CD at the local bank. The bank would then lend that $10,000 to the local hardware store, which would then recycle that spending around the town, supporting local jobs. Suppose that the family instead buys a $10,000 government bond that funds the stimulus bill. Washington spends that $10,000 in a different town, supporting jobs there instead. The stimulus has not created new spending, jobs, or a multiplier effect. It has merely moved them to a new town.

The mistaken view of fiscal stimulus persists because people can easily observe the factories and people put to work with government funds. By contrast, people cannot easily observe the jobs that would have been created or factories used elsewhere in the economy with those same dollars had they not been lent to Washington.

In his 1848 essay, "What Is Seen and What Is Not Seen," French economist Frederic Bastiat termed this the "broken-window fallacy," a reference to a local myth that breaking windows would stimulate the economy by creating window-repair jobs. In reality, the window-repair spending comes out of funds that otherwise would have been spent (and created jobs) elsewhere in town. Today, the broken-windows fallacy explains why thousands of new stimulus jobs are not improving the total employment picture.

### A2: Spending Mobilizes Unused Resources

#### Regardless of unused resources, government spending simply removes wealth from one part of the economy to bolster another—no net stimulus.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Critics' Objection No. 4: During a Recession, Government Spending Can Put Unused Resources to Work. This restates the overall spending fallacy. Yes, government spending can put under-utilized factories and individuals to work--but only by idling other resources in whatever part of the economy supplied the funds. If adding $1 billion would create 40,000 jobs in one depressed part of the economy, then losing $1 billion will cost roughly the same number of jobs in whatever part of the economy supplied Washington with the funds. It is a zero-sum transfer regardless of whether the unemployment rate is 5 percent or 50 percent.

### A2: Spending Increases Consumption

#### Government spending cannot affect the total amount of consumption—it just transfers wealth around.

Riedl 10 — Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation, holds a B.A. in Economics and Political Science from the University of Wisconsin and an M.A. in Public Affairs from Princeton University, 2010 (“Why Government Spending Does Not Stimulate Economic Growth: Answering the Critics,” *Wall Street Journal*, January 9th, Available Online at http://online.wsj.com/article/SB10001424052748703481004574646551469288292.html?mod=WSJ\_latestheadlines, Accessed 01-27-2010)

Critics' Objection No. 6: Government Should Subsidize Consumption, Which Represents 60 Percent of the Economy. This confuses the creation of income with its application. All income is applied somewhere in the economy: most on private consumption, some on private investment (converted from savings via the financial system), and some by government (taxed or borrowed out of consumption and investment). In the short run, the distribution of spending does not affect the total amount spent.[18] The only way to increase consumption spending immediately is to take it from investment or government spending.

Declining consumption means that either: (A) more income is diverted into investment or government spending (which is zero-sum in the short run); or (B) less income is created overall, which typically leads to less spending across all categories. For the latter situation, the solution is to create incentives for productivity that create more wealth and income for people to spend across all categories.