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The 'Stimulus' Actually Raised Unemployment

By ALAN REYNOLDS
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President Obama seized on the one-year anniversary of the American Recovery and Reinvestment Act (ARRA) as an opportunity to take credit for the belated and tenuous economic recovery.

But the economy always recovered from recessions, long before anyone imagined that government borrowing could "create jobs." And we didn't used to have to wait nearly two years for signs of recovery, as we did this time.

A famous 1999 study by Christina Romer, who now heads the Council of Economic Advisers, found the average length of recessions from 1887 to 1929 was only 10.3 months, with the longest lasting 16 months.

Recessions lasted longer during the supposedly enlightened postwar era, with three of them lasting 16 to 21 months.

Keynesian countercyclical schemes have never worked in this country, just as they never worked in Japan.

The issue of "fiscal stimulus" must not be confused with TARP or with the Federal Reserve slashing interest rates and pumping up bank reserves.

One might argue that those Treasury and Fed programs helped prevent a hypothetical depression, but it's impossible to make that argument about ARRA.

The "fiscal stimulus" refers only to a deliberate $862 billion increase in budget deficits. Importantly, only 23% ($200 billion) was spent in 2009, with 47% in 2010 and 30% in later years (according to the Congressional Budget Office this January).

How could the initial $200 billion have possibly had anything to do with the 5.7% rise in fourth-quarter GDP?

The Keynesian fable presumes that faster federal spending and consumers spending their federal benefit checks were the driving forces in the rebound.

Yet the GDP report clearly said the gain "reflected an increase in private inventory investment, a deceleration of imports and an upturn in nonresidential, fixed investment that was partly offset by decelerations in federal government (defense) spending and in personal consumption expenditures."

Since federal spending accounted for exactly zero of the only significant increase GDP, how could such spending possibly have "created or saved" 2 million jobs?

The bill was launched last year amid grandiose promises of "shovel ready" make-work projects.

In reality, as the CBO explains, "five programs accounted for more than 80% of the outlays from ARRA in 2009: Medicaid, unemployment compensation, Social Security ... grants to state and local governments ... and student aid."

In other words, what was labeled a "stimulus" bill was actually a stimulus to government transfer payments — cash and benefits that are primarily rewards for not working, or at least not working too hard.

Vice President Joe Biden suggested that much of the real stimulus will occur this year. Yet the new budget has a chapter called "Reviving Job Creation" that does not even mention the 2009 giveaway legislation.

In 2010, as in 2009, the ARRA is mainly a stimulus to government. Shovel-ready or not, highway programs will get only $10 billion of the borrowed booty, about 2%. "Nearly half of the outlays resulting from ARRA in 2010," says the CBO, "will be for programs administered by Health and Human Services or the Department of Education."

From the CBO figures, it appears that 39% to 44% of the $862 billion will be for increased transfer payments, including refundable tax credits (checks to people who don't pay taxes).

The American Recovery and Reinvestment Act of 2009 had extended federally funded unemployment benefits by 53 weeks, and another bill in November added 20 more — bringing the total up to 99 weeks in states with high unemployment.

As the Federal Reserve's Open Market Committee minutes for January noted: "The several extensions of emergency unemployment insurance benefits appeared to have raised the measured unemployment rate, relative to levels recorded in past downturns, by encouraging some who have lost their jobs to remain in the labor force. ... Some estimates suggested it could account for 1 percentage point or more of the increase in the unemployment rate during this recession."

My own estimate, in past articles available at cato.org, is that the stimulus act added about 2 percentage points to the unemployment rate.

The evidence that extended benefits have that effect is overwhelming, fully documented by the Organization for Economic Cooperation and Development and by at least two economists in the Obama administration.

It turns out that raising the unemployment rate by a percentage point or two is the only clearly identifiable effect the stimulus act had on the jobs market. It stimulated unemployment.

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