There's No Stimulus Free Lunch

It's hard to spend wise and spend fast.

By GARY S. BECKER and KEVIN M. MURPHY

How much will the stimulus package moving in Congress really stimulate the economy?

The evaluations to date have been incomplete, so we looked at the likely stimulative effect from the spending parts of the House and Senate bills -- over $500 billion -- and assessed the quantitative effects of four basic factors.

1) *How much increase in Gross Domestic Product (GDP) can be expected from the stimulus package?*

In a full-employment situation, increased government spending would largely replace private spending, so the net stimulus to GDP would likely be quite small. In the present environment, however, with growing unemployment of both labor and capital, the net stimulus would be larger since the additional government spending would put some unemployed resources to work.

For example, if the government spent money to build new homes with unemployed labor, the stimulus to GDP might be close to, even larger than, the amount spent. However, given the present housing glut, that hardly seems to be a wise policy, although it is a small part of both the House and Senate stimulus packages.

In fact, much of the proposed spending would be in sectors and on programs where the government would mainly have to draw resources away from other uses. This type of spending includes adding broadband to rural areas, spending more on health coverage, encouraging scientific innovations, developing renewable energy, as well as many other things.

As President Barack Obama recently said, "This plan is more than a prescription for short-term spending -- it's a strategy for America's long-term growth and opportunity in areas such as renewable energy, health care and education." Such spending may encourage long-term growth, but it will have little short-term effect on GDP.

So our conclusion is that the net stimulus to short-term GDP will not be zero, and will be positive, but the stimulus is likely to be modest in magnitude. Some economists have assumed that every $1 billion spent by the government through the stimulus package would raise short-term GDP by $1.5 billion. Or, in economics jargon, that the multiplier is 1.5.

That seems too optimistic given the nature of the spending programs being proposed. We believe a multiplier well below one seems much more likely.

2) *The increased government spending in the stimulus package is supposed to be only temporary, until the economy returns to a full employment level, but probably won't be.*

The evidence of past expansions of government programs is just the opposite. Once created they tend to survive and grow over time, even when the increases initially were said to be temporary. The underlying reason for this is that interest groups develop around new and expanded programs, and they lobby to keep and expand those programs.

This implies that the spending programs in the stimulus package will continue to some extent after the economy has returned to full employment. The multiplier at that time will surely be much closer to zero. Looking several years ahead, then, the average stimulus from the expansion in government spending will be smaller, perhaps much smaller, than the short-term stimulus.

3) *The effects on consumers and businesses of the stimulus package depend not only on the stimulus to short-term GDP, but also on how valuable the spending is.*

Whatever the merits of other government spending, the spending in this package is likely to have less value. A very large amount of money will be spent quickly over a two-year period: $500 billion amounts to about one-quarter of the total federal government annual spending of $2 trillion. It is extremely difficult for any group, private as well as public, to spend such a large sum wisely in a short period of time.

In addition, although politics play an important part in determining all government spending, political considerations are especially important in a spending package adopted quickly while the economy is reeling, and just after a popular president took office. Many Democrats saw the stimulus bill as a golden opportunity to enact spending items they've long desired. For this reason, various components of the package are unlikely to pass any reasonably stringent cost-benefit test.

4) *There are no free lunches in spending, public or private.*

The increased federal debt caused by this stimulus package has to be paid for eventually by higher taxes on households and businesses. Higher income and business taxes generally discourage effort and investments, and result in a larger social burden than the actual level of the tax revenue needed to finance the greater debt. The burden from higher taxes down the road has to be deducted both from any short-term stimulus provided by the spending program, and from its long-run effects on the economy.

We believe that it is incumbent on both supporters and opponents of the bill to thoughtfully evaluate each of these four factors. We recognize that how individuals will come out in their own evaluation of these factors will determine their attitude toward the stimulus package, and that there is considerable ground for reasonable differences of opinion.

Our own view is that the short-term stimulus from the legislation before Congress will be smaller per dollar spent than is expected by many others because the package tries to combine short-term stimulus with long-term benefits to the economy. Unfortunately, short-term and long-term gains are in considerable conflict with each other. Moreover, it is very hard to spend wisely large sums in short periods of time. Nor can one ever forget that spending is not free, and ultimately it has to be financed by higher taxes.

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