Center for American Progress

Government Spending Can Create Jobs—and It Has

The Lessons Are Clear When Our Economy Is in Trouble

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Introduction and summary

President Barack Obama swept into office on a mantra of "Yes, we can." Even though our economy was nearly two years into the Great Recession and jobs were being lost at a record pace, he projected a sense of optimism that, together, we could fix it. And history tells us that even when economic times are bleak, there are doable steps that a government can take that make a difference to get the economy back on a path of growth and job creation.

Indeed, there's a long history that when unemployment rises, the government steps in to pave the way for job creation. And these policies have been effective. It's time to do so again because, well, yes, we can.

There is an empirically grounded body of literature documenting the effectiveness of fiscal expansion during recessions and the importance of economic multipliers in creating jobs above and beyond those directly created by one firm or one government project.[1] The New Deal programs of the Great Depression are, of course, the granddaddy of these measures. The New Deal programs stabilized our economy, though it was the massive government job creation fueled by World War II that finally put an end to the economic devastation.

Since then, presidents and congresses of all political stripes—including the Bush administration—have embraced short-term, temporary fiscal expansion to create jobs in times of labor market weakness.[2] Each time, they worked as intended. And this isn't just the experience of the United States. Economies around the world reflecting a wide range of economic ideologies understand the importance of government action in the face of economic crises.

The role of government in our economy is not, of course, limited to times of economic distress. Government investments in basic science brought us the Internet, the microwave oven, and satellite communications, and have led the fight against cancer. Government investment in new, innovative businesses has helped many companies grow into household names. The Small Business Investment Company Program, financed by the federal Small Business Administration, helped Nike Inc., Apple Inc., and FedEx Corp. grow into the global business powerhouses they are today.[3]

Then there are the basic regulations, which create a level playing field for businesses so, for example, when you go to a gas station a gallon is a gallon, the aspirin you buy at the pharmacy is really aspirin, and the ground beef is actually beef. These basic kinds of rules prevent economically costly damage to consumers and public health. The courts enforce contracts, and markets are regulated so investors can invest with some confidence that the information they receive is honest.

Government spending is also an important part of the economy. Millions of people work for the government and millions more are employed in government-funded work and all those dollars flowing into the economy create even more jobs. For example, the Federal Highway Administration periodically estimates the impact of highway spending on direct employment, defined as jobs created by the firms working on a given project; on supporting jobs, including those in firms supplying materials and equipment for projects; and on indirect employment generated when those in the first two groups make consumer purchases with their paychecks. In 2007, $1 billion in federal highway expenditures supported about 30,000 jobs—10,300 in construction, 4,675 in supporting industries, and 15,094 in induced employment.[4]

Today, though, is a special time when it comes to the role of government. The lingering consequences of the Great Recession—the housing crisis, the jobs crisis, the fear among businesses to invest their earnings despite record profits—continue to push against faster economic growth and job creation. In short, the economy continues to suffer from a lack of demand. Monetary authorities have already pushed interest rates down to zero. Congress needs to step up and focus on expansionary fiscal policy.

Unless Congress acts, the private sector will continue to generate insufficient demand. Because customers have less money to spend due to the collapse of the housing bubble and the ensuing high unemployment, businesses have little incentive to hire and invest. The federal government can help with this. It can take measures to create private-sector jobs by moving up investments that the public needs anyway—investments in roads and bridges, investment in changes that the country needs to make, such as the movement to a more energy efficient cleaner economy, investments in education and research and development. We know this most recently from fighting the Great Recession.

Government has a critical role to play in paving the way for job creation

The analysis of economic multipliers is well known and economists have found that the multipliers are largest when overall demand is weak, like current economic conditions in the United States.[5] The American Recovery and Reinvestment Act of 2009 and other steps taken to address the Great Recession targeted funds toward a variety of specific job-creation efforts that have been shown to have created jobs and been cost-effective.

A few concrete examples of how public investments have created jobs include:

- Increased investments in infrastructure saved or created 1.1 million jobs in construction industry and 400,000 jobs in manufacturing by March 2011. Almost all of these jobs were in the private sector.[6] The reason for this success is simple: Upgrading roads, bridges, and other basic infrastructure not only creates jobs but also paves the way for businesses small, medium, and large to benefit. Infrastructure investments lower the cost of doing business, making U.S. companies more competitive. And they put people to work earning good, middle-class incomes, which expands the consumer base for businesses.

- There were a variety of ways that the Recovery Act encouraged infrastructure investment. Build America Bonds, for example, lowered the cost of borrowing for states who invested in infrastructure, which meant that public projects are more affordable for states—and ultimately, a better deal for taxpayers.[7]

- By the end of 2010, $93 billion in investments to the green economy had created or saved nearly 1 million American jobs.8 These 997,000 jobs include both the "green jobs" created directly by investment in specific industries and indirectly by their suppliers, as well as the additional jobs created when workers spend their incomes back into the economy.

- Three programs for energy efficiency retrofits, the Weatherization Assistance Program, Energy Efficiency Block Grant Program, and state energy programs collectively upgraded over half a million (530,000) buildings and employed almost 25,000 Americans since the programs began to ramp up from April 1, 2011 and June 30, 2011.[9]

- Three other clean energy programs also led to job creation. The Treasury Department's cash grant in lieu of a tax credit (known as the 1603 program), the advanced energy manufacturing tax credit (known as the 48C program), and the Department of Energy loan guarantee program together cost the government about $7 billio— and leveraged more than $12 billion in private capital and account for more than 120,000 direct jobs.[10]

- Direct aid to states, to a large extent, created jobs in the private sector. Every increase of $100,000 in state aid increased employment by 3.8 jobs for a year, of which 3.2 jobs were outside the government, health, and education sectors.[11]

- Funding from the Temporary Assistance to Needy Families Emergency Fund made it possible for 250,000 workers to find jobs through public-private partnerships.[12] These programs protect families and their incomes otherwise hurt through no fault of their own by the economic downturn. Putting a floor under them helps to ensure that the customer base for businesses doesn't totally dry up.

- As a result of the State Fiscal Stabilization Fund and other components of the Recovery Act, the Department of Education reports that more than 400,000 teachers eot to keep their jobs.[13]

Money targeted toward the long-term unemployed helped not only those individual families hardest hit by the Great Recession but also kept dollars flowing into their local communities and helped unemployed workers access health care, undoubtedly mitigating the well-documented negative health effects of unemployment. In a report for the Department of Labor, Wayne Vroman, an economist at the Urban Institute, estimated that the unemployment insurance system closed about one-fifth (18.3 percent) of the shortfall in the nation's gross domestic product during the Great Recession.[14] Unemployment benefits for the long-term unemployed have kept an average of 1.6 million American workers in jobs every quarter during the recession.[15]

In fiscal year 2010, the U.S. Department of Agriculture's Rural Development Fund allocated more than $21.2 billion to seven USDA programs that invest in rural infrastructure, businesses, and homes. These programs upgraded public utilities and community facilities provided broadband connections to businesses and homes, invested in rural businesses, and helped rural families purchase homes. In addition to improving quality of life, these investments resulted in over 300,000 jobs for rural residents.[16]

The steps taken in early 2009 brought the economy back from the precipice and created millions of private-sector jobs. Private employers have added jobs for 18 straight months, including over 300,000 jobs in manufacturing since its low point in late 2009. Overall, the private sector has added 2.4 million jobs since the economy bottomed out in February 2010, many of which are due to increased demand in the economy provided by government funding.[17] There is much more to be done, however, as this isn't enough jobs given the depth of the Great Recession.

We know that overall, the Recovery Act created or saved millions of jobs. The nonpartisan Congressional Budget Office credits the Recovery Act with increasing employment in the second quarter of 2011 by 1.4 million to 4 million jobs and reducing unemployment by between 0.5 and 1.6 percent.[18] Economists Alan Blinder and Mark

Zandi estimate that the Recovery Act and other fiscal policies resulted in 2.7 million jobs, and that without them unemployment would have hit 11 percent and job losses would have totaled 10 million.[19]

And, by taking decisive action to address the hemorrhaging of jobs and the fall in economic activity, Congress and the administration actually reduced the deficit, relative to where it would be today had no such action been taken. At the most basic level, government spending reduced unemployment and thus increased tax revenues. The current projected budget deficit for fiscal year 2011 stands at $1.3 trillion.[20] Had Congress done nothing to stop the hemorrhaging of jobs, economists estimate that the deficit would have ballooned to more than twice as large as it actually did, hitting $2.6 trillion in fiscal year 2011.[21]

Clearly, there is solid evidence that government spending can create jobs in a recession as deep and protracted as the Great Recession. In fact, given current conditions, investments in infrastructure, education, and other areas are critical to job creation and boosting the U.S. economy. This is something that economic forecasters from across the political spectrum agree on: The need now is to boost demand, not cut spending.[22]

Supply-side economics is not the answer

The supply-side mantra of tax cuts for the wealthy is not a job creation strategy for current economic conditions, especially given past policy decisions. It's important to remember that we have been living in a Bush-tax-cut economy since 2001. That brought us an anemic economic recovery from the 2001 recession. Investment growth, employment growth, and overall economic output all were slower than any other economic recovery in the post-World War II era. The result: For the first time in over a half century, middle-class families saw their incomes fall during an economic expansion, from 2000 to 2007, in inflation-adjusted terms, even as the economy overall grew.[23]

What's more, in the interest of encouraging firms to invest and create jobs, we have kept tax levels below the Bush levels for the entire Great Recession, and have already extended these tax cuts for another two years beginning in 2011. The problem we face is not that the wealthy are not rich enough. The problem is that the policies of the 2000s left us with a hollowed out middle class that should be the engine of economic growth. With companies sitting on large amounts of cash—the share of financial assets that is cash is higher than at any time since 1984—firms already have the funds to invest.[24] Given this, another tax cut isn't likely to tip the balance much, but what will is more customers, that is, more demand.

There was once bipartisan agreement that recessions called for increased spending. In January 2008, Congress passed the Economic Stimulus Act, which injected over $150 billion dollars into the economy, with the support of 165 Republicans. President Bush signed it.[25] In the spring of 2008, Congress extended benefits for the long-term unemployed, with the support of 182 Republicans. President Bush signed it into law.[26] These policy actions had their intended effect by temporarily boosting spending. But employment declines continued, especially after the financial crisis of 2008 spilled over into the broader economy.

Those consequences are still with us today—for employed and unemployed Americans alike. Yet it is increasingly apparent that the House Republican leadership has only one goal, spending cuts, even at the risk of throwing our government into default and even as a wide range of experts recognize that the key variable in demand right now is how much the federal government spends.

The last thing our economy needs is cuts in public spending. "Cut, cap, and balance" is not an economic growth strategy, it's a job-destroying agenda.

Yes, we can

Policymakers have a choice in front of them. They can create jobs. It is within their power. History shows us what works. We only need the will to take the right steps forward. We at the Center for American Progress boast a range of policy ideas to jumpstart job creation.[27] So, too, do other progressive organizations and policymakers in the Obama administration and in Congress. We aren't lacking in solutions. What we need is action.

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Endnotes

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